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STATE OF THE U.S. AUTOMOBILE INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

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STATE OF THE U.S. AUTOMOBILE INDUSTRY

WEDNESDAY, JUNE 27, 1984

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE
OF THE COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in room SD-215, Dirksen Senate Office Building, Hon. John C. Danforth (chairman) presiding.

Present: Senators Danforth, Long, Matsunaga, and Bradley.

[The press release announcing the hearing and background information on the world automotive industry follow:]

[Press Release No. 84-151, June 13, 1984]

SUBCOMMITTEE ON INTERNATIONAL TRADE SETS HEARING ON THE STATE OF THE U.S. AUTOMOBILE INDUSTRY

Senator John C. Danforth (R., Mo.), Chairman of the Subcommittee on International Trade, announced today that the Subcommittee will hold a hearing on the state of the U.S. automobile industry. Testimony is invited on the competitiveness of the industry, the effects of the Japanese auto export restraints and the future of international trade in autos.

The hearing will be held on Wednesday, June 27, 1984, at 10:00 a.m. in Room SD-215 of the Dirksen Senate Office Building.

Senator DANFORTH. In 1981, when the U.S. auto industry was in great distress, Senator Bentsen and I introduced a quota bill, and that quota bill, I think it could be fairly said, led the way to voluntary restraints which were put in place by the Japanese limiting the number of automobiles exported to the United States. That program is now in its fourth year. Some question has been raised as to the future of any restraints of exports of cars into the United States. The U.S. auto industry in 1983 had a year of record profitability. In 1984 its profits so far exceed by a wide measure those of 1983.

So the purpose of this hearing is to attempt to give the Finance Committee an opportunity to look at the present state of the U.S. auto industry and the immediate future of the course of U.S. trade policy relating to automobiles.

We are always pleased to have Ambassador Brock with us.

Mr. Ambassador, thank you very much.

STATEMENT OF HON. WILLIAM E. BROCK, U.S. TRADE REPRESENTATIVE

Ambassador BROCK. Thank you, Mr. Chairman.

If I may, I will make an oral statement slightly briefer than the formal presentation, then I will be delighted to respond to questions.

The current Japanese restraints are not scheduled to expire until March 1985; therefore, the administration has sought no decision by Japan on further restraints. I, nonetheless, welcome the opportunity this hearing affords to look at the present state and the future outlook of the U.S. auto industry.

Before giving my views on the current situation I would like to take a few moments to describe the condition of the automobile industry as this administration found it shortly after coming into office in 1981, and to list if we can the underlying causes of the industry's problems.

In 1981, the Big-Four automobile companies had a combined $7.5 billion negative cash flow from operations and were $13 billion in debt. Unemployment rates in this industry, in 1981, were twice those for the Nation as a whole. Sales of domestic cars were 6.2 million units, down by one-third from the peak levels of 1978.

Although in absolute terms auto imports in 1981 were only 250,000 units higher than their levels 4 years earlier, the fall-off in domestic car sales caused import markets share to rise to 27 percent, and the Japanese share to 22 percent.

With the benefit of hindsight, we can see that the problems of the U.S. industry have been coming for some time. These problems came to full bloom in 1979, following the oil supply disruptions. Sudden rises in fuel prices and sporadic fuel shortages of that period resulted in a sharp shift in demand from larger cars to smaller, fuel-efficient vehicles.

The U.S. manufacturers were not prepared to meet this swing in demand. High management and labor costs were in place, while quality was not. To make things worse, the real cost of buying and operating a car was shooting upward, resulting in consumers holding on to their older cars and general decreased sales.

Heaped on top of this situation, the entire economy had been slipping into the sharpest recession since World War II, resulting in severe declines in postponable purchases of durable goods and particularly automobiles.

In order to respond to some of these longstanding problems, the administration took several actions: A regulatory relief program was established, which identified 34 auto industry related regulations which were inefficient in a cost-benefit sense. However, the cornerstone of the President's initiative on behalf of the industry was his Economic Recovery Program.

What have been the results of these actions to date?

First, the industry responded by spending nearly $32 billion for capital improvements from 1981 to 1983 in order to modernize their facilities, improve productivity, and bring out new models.

To put this figure in perspective, auto industry capital spending as a proportion of sales was about 50 percent higher than in U.S. manufacturing as a whole.

Second, U.S. small car capacity increased from 1.4 million units in 1978 to 3.9 million units in 1983. The output of more fuel-efficient four-cylinder engines with front-wheel drive transaxles increased from less than 10 percent of production capacity to over a

third. And high technology and electronics were incorporated to such an extent that the auto industry became the electronics industry's number one customer.

Third, changes in many of the Government-mandated regulations of the automotive industry have been completed, resulting in estimated savings of billions of dollars to the industry and, ultimately, to the consumer.

With the recovery of the general economy well underway by the spring of 1983 and with the cap on Japanese imports, the United States auto industry was well positioned to benefit from increased auto demand.

U.S. car sales in 1983 were up 1.2 million units over 1982, with a whopping 87 percent of this increase going to domestic firms. This resulted in a record nominal profit for the U.S. auto companies of $6.2 billion, with a return on sales of 4.54 percent, surpassing the 4.05 percent level reached in 1978, the year many analysts consider the industry's last good one.

Through the first 5 months of this year the picture looks even brighter. Domestic car sales are up over 25 percent from last year, total car sales this year—imported and domestic—are expected to exceed 10 million units. And U.S. corporate auto profits may reach a record $10 billion.

The import market share which had peaked at monthly levels in excess of 31 percent in 1982 has averaged just over 22 percent through May 1984, a fall of about a third in 2 years. Likewise, Japanese import share declined to slightly over 16 percent in this recent 5-month period from its high of over 22 percent.

Employment, however, is the measure of recovery and health which most of us consider of primary importance. Employment among the automobile manufacturers, which had dropped from over 1 million workers in 1978 to 700,000 workers in 1982, was again reaching over 860,000 workers in May.

Also, many of the U.S. auto jobs were lost not to imports but rather to plant modernization, robotics, and the increased share of small car production. These are jobs that would never have reappeared in auto plants regardless of the level of imports, but have reappeared in other industries and sectors. The economy as a whole has generated over 5 million jobs in the last 12 months, 6.5 million in the last 18, giving further relief to those displaced from the automotive as well as the auto supplying industries.

But the strong recovery of the last year has a possible downside. Manufacturers and suppliers who cut costs under the pressure of falling domestic sales and import competition may, with bigger profits, be tempted to back away from their stringent managerial practices. Already we have witnessed very sizable salary and bonus packages being awarded to auto executives at a time when nonmarket forces are increasing the prices of automobiles.

Independent analysts have forecast that even with larger profits the auto manufacturers will be spending in the red in the next few years for capital improvements necessary to stay competitive. With the possibility of higher salary and wage costs, an outside observer might wonder from where the investment funds were coming. Without these investments, one would certainly wonder from where the future auto jobs will come.

The special actions taken by the Government were designed to lessen the effects of the unusual coincidence of severe structural pressures on the U.S. industry with the downturn in the business cycle. The general economy is now growing; the U.S. auto industry is increasing sales, profits, and employment. This program is commendable—the progress is commendable—but the industry cannot abate its efforts.

The long-term structural problems of this industry have not gone away, nor can Government make them go away. The industry must respond to challenges—such as saturation of mature markets, increased automation, changes in technology and consumer tastes, higher energy costs, and new competitors operating from both foreign and domestic production facilities.

No one, more than I, hopes that both auto executives and workers can be increasingly better compensated for their jobs. However, this compensation cannot be sustained by indefinite trade restraints which increase the price of a car beyond the means of many of our citizens—people who make far less than those who work in the auto industry. That increased compensation must be earned by increased commitment to quality and productivity.

For its part, this administration is committed, along with our major trading partners, to halt protectionism, and as recovery proceeds, to reverse it by dismantling trade barriers. We do not follow this policy based upon an idealistic view of world trade nor of how others in the trading community may sometimes act. Rather, the pursuit of freer trade is a necessity for the continuation of the present economic expansion on a worldwide basis—and with it, the preservation and growth of American jobs.

The situation and needs of the auto industry, as they become clearer over the next several months, must be measured on the same scale as those of consumers and workers in other industries.

We have learned from experience, Mr. Chairman, that U.S. industry stays competitive, efficient, profitable, and growing when it must make the tough decisions and necessary investments that come from a competitive environment.

One past mistake that we have allowed is for some industries to get fat and lazy. We cannot let this happen again—for any reason. Our future national well-being depends upon our ability to meet the competition, not to be isolated from it.

Thank you.

Senator DANFORTH. Mr. Ambassador, thank you very much.

We are now in the fourth year of a voluntary restraint program. You have been in your present office since the beginning of that program; you have certainly been in a position to form conclusions as to the effectiveness of the voluntary restraints and whether they were a net plus or a net minus as far as the United States is concerned. Mr. Crandall, who will testify later this morning, has called into question the effectiveness of limiting the number of Japanese cars to come into the country. He believes that the effect of this is that the Japanese were able to boost their earnings, sending in fewer cars but at much higher prices, and that they did much better with the voluntary restraints than did the United States auto industry.

He also points out that the cost to the American consumer of the program was about $4.3 billion last year, and that that is about $100,000 a year for each job in the auto industry saved.

So my first question is, looking back over the last 3-plus years of voluntary restraints, do you think that they have been a net plus or a net minus as far as the United States is concerned?

Ambassador BROCK. Senator, I am glad we did it. I would accept some of Mr. Crandall's arguments that the Japanese probably made more money out of it than we did, but that's not an argument not to do something. If you have an industry that is desperately in trouble, and the automobile industry was, not entirely from reasons of their own making, and you don't act to give them time to get competitive, then you run the risk of far greater damage. And I think we took a reasonable risk and achieved a reasonable result. We have a healthy industry, and I'm not sure whether we could say that today had we not taken the action we took in 1981.

Let me take 1 minute to recount just a bit of history, because everybody finds it very convenient to blame the U.S. management and workers in this industry—for some things which were deserved, but for some which were not.

In the Irani-Iraqui war, I don't know of anybody in this country—automobile executive, worker, anybody else—who predicted that war, nor its consequences. But when it broke out and the energy crisis hit, again, effectively the second energy crisis in something like 7 years, gas lines formed and American consumers started desperately trying to buy fuel-efficient cars. The only cars available were Japanese cars that were sitting on the docks unsold. They hadn't been able to sell them. They had 300,000 units in inventory on the docks when our consumers changed habits.

Well, you can't put out a new car in 1 or 2 years, or 3 or 4. It takes you 4 or 5 years at best. And we needed time to retool this industry and to get competitive, with a quality product and a quality price, and I think we gave them that time.

Senator DANFORTH. I thought that both we and the Japanese were just selling larger cars then. Are we building smaller cars?

Ambassador BROCK. Well, as the energy crisis has receded from our consciousness we've gone back to bigger cars. We're making and selling every big car we can in this country. The Japanese are making bigger cars, the American manufacturer is making bigger cars, and that's because the American people do a lot more driving—we've got a bigger country, and we like larger cars. But you can't put that on the manufacturer's or the worker's back; that's simply a decision of the consuming public—that's what they want, and that's what is selling.

Let me take one other point that Mr. Crandall makes in his statement, about if it would have been better to do it by tariff. I generally agree with that. I happen to dislike quotas intensely. They are uneconomic, they raise our costs, and we get very little economic benefit; and tariffs at least are quantifiable, and we get some revenues out of them.

The problem with a tariff is that you have to do it on a most-favored-nation basis, and I don't think anybody really thought that for the British and the Italians and the Germans—putting the

same restraints on them would have solved our problem. Yet, we would have had to do that if we had gone the tariff route.

So there were other factors in the decision to use the voluntary restraints. And in response to your question, on balance I think the industry has benefited from that decision, I think the American people have benefited, and I think it was a cost-efficient decision.

Senator DANFORTH. We have held several days of hearings in the Commerce Committee on domestic content—for some reason that issue is in the Commerce Committee's jurisdiction—and the point has been made by the supporters of domestic content that in their view if voluntary restraints go off next spring the result will be that there will be a surge of Japanese imports, and that the Japanese might be taking over up to 40 percent of the United States auto market. Would you anticipate that to be the case? And if that does appear to be the case, if those predictions are right or close to being right, would the administration, if you are part of the administration and if we have the same administration next spring, would the administration likely take a hands-off position? Or would it likely attempt to put in place some form of restraint to prevent the surge?

Ambassador BROCK. First, I don't really believe that any reasonable person would expect that to happen. I can't imagine our industry being so supine as to let it happen. First of all, we're not flaccid, weak, noncompetitive people; we don't back off from that kind of a challenge, and we're willing to live up to it. So I frankly have a lot more confidence in our industry than those who are trying to "help" it do.

Second, I don't think the Japanese industry would want to get into a situation where Government intervention was necessary. Again, I don't expect them to try to abuse what is still a competitive advantage on their part in terms of the cost of production.

But to answer your last question as to what we may or may not do, that's tough to answer. I would guess I'd have to rely on the fact that we have very solid trade laws in place, Mr. Chairman, that work occasionally in fits and starts but that are available for the industry.

If in fact such a situation arose and the U.S. industry was in fact being injured by imports as the principal cause of that injury, they have a remedy under U.S. law, and they could seek it.

Senator DANFORTH. A time-consuming and sometimes unsuccessful remedy. I mean, if the shoe industry can't use that remedy even though imports are at 70 percent, I'm wondering if the auto industry could take comfort in being able to avail itself of it if imports were at 40 percent.

Ambassador BROCK. Well, percentages are not as important as the facts of the injury and the causative elements thereof.

I have discussed with you on other occasions the shoe decision, and you have expressed yourself with some clarity on that, but I really think in an industry this big and this consequential, the industry can be determined with some precision, and the time that it takes is not so long as to jeopardize the existence of the industry.

I think our laws could use a bit of tightening up, in all candor, but even without that we have the capacity to respond quickly if we need to.

Senator DANFORTH. Do you mean even without the statutory scheme?

Ambassador BROCK. Well, yes, it's true that we have——

Senator DANFORTH. The administration wouldn't just do nothing, would it? It wouldn't just say, "Oh, well——"

Ambassador BROCK. We are not going to ignore a threat to the survival of a basic industry, Senator, of course.

Senator DANFORTH. You mention in your testimony that the fuel lines were an external cause of the problem of the auto industry in the late 1970's, that that was one of the prime justifications for setting the course toward voluntary restraints.

One of the causes of the problem now, and I think everybody concedes this, is the relative value of the dollar and yen—an overvalued dollar and an undervalued yen—and the fact that, regardless of competitiveness of the United States industry, that provides a great boost to Japanese exports.

Would you anticipate that that differential in the value of the dollar and the yen would provide the basis for any kind of offsetting policy, offsetting action?

Ambassador BROCK. No, sir.

Senator DANFORTH. Do you mean we just follow a policy in our country of a highly valued dollar, and the Japanese follow a policy of an undervalued yen, and if that has any trade consequences, that's too bad?

Ambassador BROCK. No, I hope we don't do that. But I would point out to you that the yen is higher than it was 10 years ago, in relative terms, that the dollar has been stronger against virtually all other currencies, more so than the yen, that you can't really put all of this burden on the yen.

I think the yen valuation has become a bit of an excuse. If we look at the relative value of the yen, that's changed, in negative terms, far less than the mark, the franc, the pound, the lira, and most of our competitive currencies.

The important point is that the value of the dollar is extraordinarily high. I do not accept the definition of overvaluation, because the market makes its own valuation and I have to accept the judgment of several million people buying and selling every day; if they don't think it is overvalued, it's not.

Senator DANFORTH. Well, regardless of the cause, I think most people believe that the dollar relative to the yen is considerably overvalued, and that's a very large part of the trade problem, not the inherent productivity of the Japanese or pricing policy or quality of product, but the advantage that the difference in currency valuation has given them.

Ambassador BROCK. Senator, if we continue to do that it becomes something more than an intellectual exercise, it becomes a bit of an excuse for inaction.

I grant you that the dollar is exceptionally high and is costing us a great deal in trade terms. It is primarily a factor of the Federal deficit and the very high interest rates in this country, which has held the dollar above what normal trade terms would dictate.

But let me point out to you that the cost of production in the United States in this particular industry is exceptionally high. I think the best way to make a comparison is not on the basis of dol-

lars but on the basis of the number of weeks of earnings that it takes to buy a product.

I want to take you through, if I may, some numbers: In 1960 the average American had to work 35 weeks to buy a new car. We got efficient. The 1960's were a good decade. In the early 1970's it only took 28 weeks to buy a new car. We saved 7 weeks of earnings. But then we got prices going up again, faster than the average wage of the average American. This industry was accelerating its costs and its wages and its salaries faster than the average of all workers in the United States. By 1978 it took 31 weeks. By 1980 it took 32 weeks. By 1983 it took 37½ weeks of earnings of the average citizen in this country to buy a car, a U.S. car.

Now, if you look at that, and you look at the average wages in this industry, the average salaries, the load of overhead, if you will, of management, the elements of the cost of production—those factors are significantly larger factors than any estimate I have ever seen on the yen-dollar relationship. And if we don't deal with the effective competitive elements of cost of production, it does no good at all to talk about relative values of the yen and the dollar, because those are factors over which those workers and those people in management have no control. The only people who can control the relative value of the dollar are here on this hill.

Senator DANFORTH. That's right. I mean, that's what we are here for. You and I don't make cars, but we could devise if we wanted to some sort of offsetting system, I would think.

Ambassador BROCK. It has been pretty hard to get this deficit down; you all have had some agonizing debates.

Senator DANFORTH. I don't mean just the deficit; I mean maybe we could do something a little more artificial than that.

Ambassador BROCK. Well, I don't know what it might be.

Senator DANFORTH. You and I are both opponents of domestic-content legislation. Some countries, though, have domestic-content legislation—Australia, Mexico. How are we dealing with that, or how could we be dealing with that? How should we be dealing with that problem?

Ambassador BROCK. Well, we have dealt with it by putting plants in those countries and producing products there.

We don't export cars to any effective degree; our exports are down to virtually zero, $350 million, and until the dollar value changes in relationship to other currencies, until we produce a better product at a lower price, we probably won't.

Senator DANFORTH. So, in other words, their domestic content policy works? We have gone along with it.

Ambassador BROCK. I hope we don't think it worked to the extent that we want to follow that example. I certainly don't want to be like Mexico.

Senator DANFORTH. But is there anything that we do to compensate for other countries' domestic-content legislation, or to provide offsets or disincentives of one kind or another?

Ambassador BROCK. We have the authority to seek offsets or compensation if we in fact are injured. There has been no filing of that request by anybody in the industry that I am aware of.

Senator DANFORTH. Under what statutory authority would that take place?

Ambassador BROCK. You could seek a 301 approach if the industry felt that it could demonstrate some damage.

Senator DANFORTH. That would be viewed as an unfair practice?

Ambassador BROCK. It certainly could be, surely.

Senator DANFORTH. It should be; I'm not sure that it would be.

Ambassador BROCK. I don't really know that I can recreate history. I don't know what the decision process was in U.S. industry back in the 1950's and 1960's when these decisions were made on the siting of plants. But the United States—Ford Motor Co. has an outstanding plant, for example, in Australia. I assume that they did it for economic reasons, and I don't know whether domestic-content law was part of those reasons or not. They have plants, as does General Motors, throughout Europe, and they have made a good deal of money out of that.

Again, I am not sure but I don't think there are any domestic-content rules in Europe that motivated that siting. It was simply that shipping costs were larger than the profitability of making here and shipping to there, so they made an economic choice.

But if in fact a country in a new circumstance were to make this law, and it did damage U.S. exports, we would have a remedy if we wanted to use it, if the industry would seek such relief.

Senator DANFORTH. Senator Long.

Senator LONG. Ambassador Brock, there are certain areas where a foreign producer has a comparative advantage, by a decision of this government to confer it upon him.

Now, the most obvious case to me is our tax structure. European countries have value-added taxes that run as high as 18 or 20 percent, and when we enter their market there is a border tax waiting for us with our product, to be imposed on our product headed their way.

When they ship it in our direction they rebate that value-added tax, and that's more than enough to pay for the insurance and freight and shipping it into our market and gives them a nice edge in doing business over here.

Now, one of the principal reasons it got that way was that in negotiating that General Agreement on Tariff and Trade many years ago, our people agreed—at a time when we were rich and everybody else was poor—that we couldn't count that Social Security tax as a tax on consumption, the way they count their value-added tax. The Social Security impacts exactly that way; it is just that their cost of doing business is passed on through to the consumer, and you know that as well as I do. So, we can agree on that, can't we? I see you are nodding.

Ambassador BROCK. Yes.

Senator LONG. So that is correct.

All right now, if we wanted to, we would—and personally I think we should—find a way to give our producers the same opportunity that those people have. And I'm told that the Japanese don't do it exactly the same way, but that it is a distinction without a difference; it works out to a tax on consumption rather than a tax on production.

Ambassador BROCK. Yes.

Senator LONG. Now, if we did the same type of thing, we would have a right, if we wanted to, to give these producers a credit for

the consumer taxes like the sales taxes that they are paying into the State governments against what they owe the Federal Government--if we wanted to do business that way. There is no reason why not, is there? If we wanted to do it, we could do it, couldn't we?

Ambassador BROCK. I think if carefully done it could be done, yes.

Senator LONG. Well, if you would just do something I advocate on occasion—not with a bill, but I have advocated in speeches I have made that we ought to consider substituting a value-added tax for the Social Security tax, if only in the automobile industry. For example, we could say, "All right, now let's give our people the same break that Japan and every foreign country gives their people." So, you would just collect the same amount of money, but you would collect it as a value-added tax rather than as a Social Security tax. Put it in the Social Security fund—it is immaterial where you put it. But you can't use it as a Social Security tax, because we agreed at a time when we could afford to agree that we weren't going to do business that way, that we weren't going to take credit for that in our trade policy.

Ambassador BROCK. That's right.

Senator LONG. Now, I discussed this matter with our friend Olivier Long—no relative so far as I know—he was the Secretary General of the General Agreement on Tariff and Trade.

Ambassador BROCK. That's right.

Senator LONG. And I asked him, "If we did something of that sort, would our trading partners have any right to react against that or to take some action against us?" And he said "No." He said, "How could they conceivably do that, if all you are doing is the same thing they are doing? You would just be taxing your people the same way they are taxing theirs and taking credit for it the same way they do."

Now, if we wanted to do that, there is no reason why that wouldn't work, is there?

Ambassador BROCK. No, sir.

Senator LONG. All right. So now, if we pursued such an approach, we could collect a lot of money for this Government, just a lot of it, to help with our deficit, because all of these automobiles coming in would pay the same value-added tax that we would be paying. There would be no net increase in taxes on our industry, would there? I mean there would be no increase on our people if you levied about the same amount that the Social Security tax cost.

Ambassador BROCK. That's right. If you would use that on offset, that's right.

Senator LONG. You would just figure out about what you collected on Social Security taxes from those people, and just levy the value-added tax to bring in about the same amount of money.

Ambassador BROCK. I am a little cautious, Senator, about doing it for one industry like this; I think you might have a little tougher time proving your case. But if you are talking generally, I don't think there is any question about it.

Senator LONG. Well, you can just do it as a manufacturer's excise tax on automobiles, if you want to; it impacts the same way, and you're entitled to the same credit against your export.

Ambassador BROCK. Well, go ahead.

Senator LONG. There is no point in arguing about precisely how you do it—there are all kinds of ways you could do it where you just put it on this particular product. For example, if you want to you can just put a manufacturer's excise tax on automobiles in port. If you want to do it, you can do that.

Ambassador BROCK. Right.

Senator LONG. All right now, that would then bring a large amount of revenue to our Government. Even compared to the Social Security tax, my studies of it indicate that one point of a value-added tax, if you look at the things that we would ordinarily exempt from a value-added tax like the sale of a home and things like that, one point of a value-added tax just about equates to one point of a Social Security tax, the way we do business in this country. So we would in effect be collecting maybe 18 percent. With the Social Security tax you are talking about a 14-percent burden on their product, which is at the present time is just a one-way burden on ours and not on theirs. That would, one, collect a lot of revenue for this Government; two, it would put us on the same basis in trading with them as they are in trading with us; and, three, it would help to wipe out or to reduce a comparative advantage which the other fellow has purely by a decision of this Government.

Ambassador BROCK. You know, Senator, it is really hard for me to be very specific in responding until I see precisely how it would work; but the point you make is absolutely right. In Japan, for example, there is a commodity tax based on the size of the engine that runs from about 17½ to 22½ percent, somewhere in that range, but let's take an arbitrary 20 percent. You know, on an $8,000 car that's $1,600. That's a great deal of money; it really is. And anybody has to pay that—whether you make your car in Australia and send it to Japan or here. You've got to pay that going in, just as the Japanese manufacturers do. But if they sell that car out of Japan, that tax is rebated at the border. So they have effectively paid no tax on the car that is coming here.

That is where you get into this competitive disadvantage with American manufacturers, obviously who get no such treatment. I mean, you have to pay State taxes, local taxes, sales, ad valorem, all the rest, plus your corporate taxes, and all your parts carry a tax system, based on them, too. So you do have that problem.

Senator LONG. I can't remember which country it was, but when I was in Europe—you talk about a sophisticated group of business people—we had talks in Brussels with the Belgians, Amsterdam with the Dutch, and then again in Frankfurt with the Germans, and the Belgians, maybe more than that—one of those countries told me that they put their value-added tax in play because they had to do it in order to be competitive with the other nations in the European Community.

Ambassador BROCK. That's true. England was required when they came into the Community to put a value-added tax on. It went from 10 to 15 percent.

Senator LONG. Well, it just seems to me that if you want to stay by the General Agreement on Tariffs and Trade, if you want to stay by those rules, then you ought to be advocating that we

modify our tax system, give our people the same consideration we are giving the other fellow, because if you add the 14 points—just comparing it to the Social Security tax to our situation, to a value-added tax—add that to the overvalued dollar then that works out to almost 40 points.

Ambassador BROCK. Yes.

Senator LONG. Now, who on God's green earth can compete if the other fellow is worth his salt and he's got 40 points advantage? You know, the Japanese are not just a bunch of backward people anymore; they are up-and-coming, hardworking, industrious people. And the rest of the world is getting to be that way. Isn't that correct? We know that's so, right?

Ambassador BROCK. It sure is.

Senator LONG. Well now, it seems to me that some of the rest of it, some of this difference in the exchange, the overvalued dollar, a lot of that has to do with the fact that we are assuming the burden of trying to defend the whole free world.

Ambassador BROCK. Yes.

Senator LONG. And again, that's a decision by this Government which results in a very heavy burden on our people competing with the other guy.

Ambassador BROCK. Absolutely true.

Senator LONG. And frankly, I think we ought to find out a way to do something about that.

But my thought is that the first step ought to be simple enough. Now, as far as automobiles and steel are concerned, they are two industries that would be in a lot better position to compete if we just took the first logical step. And I don't know why we don't start thinking in those terms.

I talked to Mr. Frazer about it when he was the head of the United Automobile Workers, and he was sure ready to do his part; it just took other people to participate. And I don't know why we don't start thinking in those terms.

Ambassador BROCK. Well, there is a good deal of thought going on. A lot of studies are underway in Treasury now to take a look at the tax system and the competitive situation surrounding us.

You know, when we put the income tax in place and the payroll tax, those two taxes really were put in a long time ago when we had a very different competitive situation in the world. We didn't think about these things. And I think it is past time that we start looking at our whole tax system in the context of global competition—I really do. I think you have raised an enormously important point.

Senator LONG. I would be very reluctant to vote for the component bill, the domestic content bill, if we are talking about making our people compete on a reasonable basis with the Japanese, the Europeans, and others.

Ambassador BROCK. Yes.

Senator LONG. But when we are talking about as much as 40 points of unfair advantage imposed by this Government, then I do find myself thinking, "Well, doesn't this industry have a right to ask for help, when this Government is putting that kind of a burden on our producers?" I mean, if they are being put at that kind of a disadvantage by a decision of our Government, one, to

engage in policies which result in this overvalued dollar, and then, two, to engage in tax policies which create a 14 point to the 40, then I find myself thinking that those people do have a right to come in here screaming to the high heavens. I think if I were in their situation I would be screaming.

Now, I guess General Motors is kind of happy about that situation; I understand that they don't want any protection for the industry. They've got their deal made with the Japanese, it looks like. Well, that's all great. I read what Mr. Iacocca said; it looks like he said, "Well, that's all great. They'll make more money selling those Japanese automobiles than they were making manufacturing them here." Well, if that's what they've got in mind, that's just great from their point of view. But it is one thing to put the pressure on our workers to be efficient and effective and competitive, and it's another thing to impose on them an unfair burden as a result of our Government's decision. Then I don't see how you can defend that and say nothing should be done. There is a 40-point disadvantage that our people have to contend with because of the way this Government chooses to do business.

Ambassador BROCK. But Senator, with all respect, first of all I would debate the 40 points. But even if I accept that, the assumption of your statement that we ought to protect one industry and the heck with everybody else——

Senator LONG. I am not saying "protect," I'm saying treat them as well as the other guy treats his people. Treat them the same.

Ambassador BROCK. But a domestic content bill singles out the U.S. automobile industry for a subsidy by every single other American worker in the United States. And I don't see how you can justify that, because every other worker still has to endure the same problems that the autoworkers do. The same competitive disadvantage occurs in steel, occurs in textiles, occurs in footwear, occurs on the farm, for our teachers. Everybody else is paying the same price because of an overvalued dollar, because of the present tax system.

You can't say the domestic content can be put on 99 percent of the American people for the benefit of 1.

Senator LONG. Well, I can't see any solution you've got for us here, except to say let them all go out of business, and I don't think that that's any answer, either.

Ambassador BROCK. Nobody's going out of business in this country, Senator. This country has the broadest-based, strongest, healthiest recovery it's had since World War II. We are in the midst of a super good recovery right now.

Senator LONG. Yes, and we're running a deficit of $140 billion this year in trade, and they say it's going to be almost twice that next year. And you've got a deficit that's 5 percent of your gross national product—unheard of Federal deficits.

Ambassador BROCK. But domestic content doesn't deal with that.

Senator LONG. How long can we keep that up, running a $200 billion deficit in our domestic budget and a $200 billion deficit in our trade accounts?

Ambassador BROCK. I don't think you can. I really don't. But you are debating every day. You went through an agonizing conference last week on a downpayment to begin to deal with that problem.

The Congress, the administration are wrestling with that problem right now.

Senator LONG. But, Mr. Brock, what that's going to do for the problem I am talking about I could put in my eye and it wouldn't hurt me, for what little difference that is going to make. [Laughter.]

We're going to have to move on the program here, and we've got to do something about the trade problem that's going to make a real difference, not just conversation.

Ambassador BROCK. I don't disagree with you. I really don't disagree with you. All I am saying is don't do it to one industry at a time. Domestic content is the worst of all answers, because nobody gets any value out of that.

Senator LONG. What I am asking you about is not "domestic content," I'm saying why don't we do something about these other things, because if we do you might not have to have the domestic content.

Ambassador BROCK. Fine. I'd be delighted to work on that with you.

Senator LONG. Thank you.

Senator DANFORTH. Let me ask you just one question, Mr. Ambassador, following up Senator Long's very good line of questions.

Clearly, tax policy has a lot to do with trade policy.

Ambassador BROCK. Yes, it does.

Senator DANFORTH. And if we are going to move to a consumption-based tax or to a value-added tax, or if we are going to swap Social Security taxes for value-added taxes, that would have a very significant effect on trade.

Also, some people are beginning to think that we have made a mistake in moving away from tariffs toward quotas as the way of protecting various industries. Maybe that's been a mistake; maybe it's been a more artificial type of barrier to trade than putting it all in dollars and cents terms.

It is well known that the Secretary of the Treasury is looking into changes in the tax law including possible simplification, base broadening. And it would seem to me that it would be very important for you to be a part of those discussions within the administration. I don't know if you are or not, but I just offer that as a suggestion. I would hate to see the administration come out with sweeping proposals for changing the tax laws which may or may not have an effect on trade—probably will have an effect on trade—without considering the trade consequences in advance.

Ambassador BROCK. I am absolutely in agreement. I am absolutely confident that I will be involved. I spent an hour with the Secretary of the Treasury either yesterday or the day before on this subject, expressing my concern and raising some of the issues that Senator Long has been raising today in saying that we really are in a position now where we do have to look at our tax system very carefully and see if in fact we are being given a real opportunity to compete. I have great concern about it.

Senator DANFORTH. This committee, as you know, has jurisdiction over any tax bill that will be coming our way, and I would hope that the administration would take to heart our concern that any changes in the tax laws as sweeping as they are being rumored

would have your input and the input of the USTR in their preparation.

Ambassador BROCK. I will try very hard to be involved; I don't think that will be difficult, Senator. The problem we have is that we really don't have a lot of time this year to do anything dramatic. We've just about run out of legislative time, et al.

Senator DANFORTH. Well, maybe not this year.

Ambassador BROCK. No, the thing to do is to take some time now to do our homework and to try to prepare a case for whatever change might occur in the early part of next year.

Senator DANFORTH. Senator Bradley.

Senator BRADLEY. Thanks, Mr. Chairman.

Mr. Brock, I would just like to follow up on the last series of questions. As we look at next year and the possibility of having another tax bill, maybe a different kind of tax, maybe some fundamental reform, what would you suggest would be the most helpful direction that tax policy could take from the standpoint of improving U.S. competitiveness? If we believe in the market, do we really want the market to allocate the resources because we believe it does it most efficiently? Or do we want to try to guess in our committees, in the Finance Committee and in the Ways and Means Committee, as we have always done, to try to determine what group gets one advantage? That's one question.

The second question is: How do you put that into the general context of restoring U.S. competitiveness?

Ambassador BROCK. That is the fundamental question, and I hope we spend a lot of time this year debating it. It ought to be part of the election debate, as far as I am concerned.

I really do want to get away from Government guesswork, Senator. I think the market is a far more precise mechanism for determining these things, and it seems to me that whatever we end up with has to at least move as close as we can to that as an ideal.

There are a couple of areas that I think deserve attention. And I'm not wise enough to sit here and throw out a tax system; I don't have that expertise. But a couple of factors do have to be kept in mind:

First, and maybe most fundamentally, we have in this country put our whole tax premise at the Federal level on a tax on earnings, on savings, on investments. As a consequence in contrast with the other countries, Europe as well as Japan, our rate of savings is considerably lower, and therefore we do not form a capital pool of such a magnitude—other than just because we're big—that allows us to keep our interest rates down as others might be able to do and to do other things that we would like to do as a society, to spend at the Federal level, for that matter.

So I think one consideration has to be whether or not we should move somewhat away from the tax on effort, earnings, savings, investment, and more toward a tax on consumption. At least, that is worthy of some serious study.

Second, I think part of our problem is that we have gotten so enormously complicated in the tax system, by trying with legitimate social reasons to motivate people to engage in this activity or that activity, whatever it happens to be. But by setting up this whole range of tax expenditures, I think we have put Government

more into the decision phase of business judgment than I would like to have it. It seems to me that the market should be making a lot more of those judgments than we in Government, and if we could draw back a bit from the excessive intervention in individual decisions by a tax policy, I would be a great deal more comfortable.

The last point I would make is the point that Senator Long was making so effectively, and that is that we have made a decision that the income tax is our fundamental tax. And I find no fault with that—it's a progressive tax, it basically attempts to be an equitable tax. But by putting the whole premise of our tax system on that when others are using the value-added tax, or some such consumption tax, we put ourselves at a competitive disadvantage. I at least think that this ought to be part of the consideration when you talk about any change. It seems to me that it is increasingly difficult when our country is ever more involved in the world, ever more involved in trade and ever more dependent on trade, that trade ought to have a larger voice in the mix, the matrix of tax policy.

Senator BRADLEY. So, in summary, you are saying: Consider a consumption tax in order to encourage savings, reduce tax expenditures dramatically, and look at a value-added tax as a possible tax that would improve trade competitiveness?

Ambassador BROCK. Well, I'm not sure I would state it that categorically, but I'm saying that those questions have to be addressed, yes.

Senator BRADLEY. One other question. I would like you to make this judgment as it relates, say, to the automobile industry.

There have been a number of articles written recently as well as a great deal of public attention focused on American ownership and management of corporate enterprises being different, that the owner of an enterprise conducts himself or herself in one way, the manager of that enterprise sometimes does not conduct him or herself the same way.

My question to you is, as you look at our trade competitiveness, do you see any disadvantage or advantage accruing from the fact, in the automobile industry, that you have a management that is divorced from its shareholders?

Ambassador BROCK. Interesting question. Generally speaking, I think American managers have treated their responsibilities as if they were owners as well as managers.

Senator BRADLEY. That's not what Walt Disney says.

Ambassador BROCK. I know. But there are exceptions, as you have noted.

I don't know that I know enough about the day-to-day management process in the automobile industry to make such a criticism. I do think that we have been a little bit facile in coming down on the management decisions of the automobile industry, and a little bit too quick. You know, they spent 10 years getting battered by oil embargos, by changes in governmental policy that occurred every 6 weeks, by soaring costs and shifting consumer demands. I don't know whether they would have acted in a different fashion if they had been—

I guess in this case you have been very critical of the management of the auto industry, particularly in their recent bonuses.

Ambassador BROCK. Yes.

Senator BRADLEY. And my question to you is, is that an example where if there were owner-managers instead of managers, that that might not have happened? Does that have any effect on our trade policy? I am giving you an opportunity, if you want to avail yourself of it.

Ambassador BROCK. If they were owners that would not have happened. That's obvious. Sure. [Laughter.]

I guess in all honesty, and what I tried to say in that statement is, I don't have a right to single out anybody for what they make—manager or worker. That's not my job.

It is my job to say: If you are going to have significant increases in bonuses or wages, or both, it is ethically difficult, then, for me to defend continued subsidy on the part of the American people imposed by Government to those individuals and workers and managers and firms. And that's what protectionism is—it is a subsidy; there is no other way to calculate it. You can put it at $400 a car, $600, $800 a car, I don't know; but I do know it's a subsidy, and I do know that when the average wage in the automotive assembly companies is 60 percent above the manufacturing average in the United States, it is very difficult for me to justify continued subsidies when the average citizen makes a lot less money. That's all.

Senator BRADLEY. One last question. As you look at the automobile industry in the next decade—you know, I've seen some studies and you've seen some studies as to what percent of the automobile will be made outside the United States. Does that concern you at all? And if you draw implications from that for employment, what do you say to those workers that might be displaced from rather well-paying jobs, well-paying relatively, as compared to other unions? If this is so, they are not going to have jobs. What do you say to them?

Ambassador BROCK. Well, it does concern me. My judgment is, the ultimate jeopardy to American jobs in this industry is to protect this industry, either through domestic content or through some other form of Government intervention, and thereby deny the working of the market. I think that's the longest term and greatest hazard to those jobs.

But, Senator, you and I know, and so do the people in those plants, that if the American automobile industry is going to compete 10 years from now it's going to be a very different industry from that which we now see. They are going to be using robotics, lasers, every other mechanical and other device they can to improve their productivity. It's my judgment that less people are going to be working in the automobile industry no matter how many cars they sell.

Senator BRADLEY. But do you believe Government or the industry itself has any responsibility to those workers who will be permanently displaced?

Ambassador BROCK. Yes, sir, I certainly do. I think both of us do.

Senator BRADLEY. And what is that responsibility?

Ambassador BROCK. It is, first, to create a maximum degree of skill before they get into the workplace, so that they have flexibility; second, to continue that work training and educational process throughout their employment career so that they have some oppor-

tunities if they do lose their jobs because of technology—or imports, it doesn't matter; a job lost is a job lost.

Third, to be supportive when the job is lost, in terms if necessary, of retraining to a new skill and perhaps relocation. I think if you look at the last auto wage pact, General Motors signed a pact if I remember, giving 5 cents an hour for retraining, precisely because of this prospect. I think we in Government ought to find ways to encourage and support that. I think other companies are going to have to accept an equal level of responsibility. Because this country is going to change. If we don't, we are going to die. And we have to simply allow that change and make it human in its impact, and not treat it as if it was just numbers. These are people out there, and we have to help them.

Senator BRADLEY. Do you think existing agreements in the auto industry and the Federal budget adequately take those transitional needs into consideration?

Ambassador BROCK. I think we have tried, but we have changed our laws so dramatically in the last few years that I am not sure I can give you a good answer to that until we have seen it work a little bit longer. But I do think we have to watch this one from now on. I think it is a continuing problem.

And I do think we in Government have a significant role to play and have to keep that role in mind.

Senator BRADLEY. Thank you.

Senator DANFORTH. Mr. Ambassador, thank you very much.

Ambassador BROCK. Thank you.

[Ambassador Brock's prepared statement follows:]

Statement of

Ambassador William E. Brock
United States Trade Representative

Before the

Subcommittee on International Trade
of the
Committee on Finance
United States Senate

June 27, 1984

Mr. Chairman,

In May of 1981, the Government of Japan decided to restrict its automotive exports to the United States. They took the action in recognition of the difficult adjustment situation that the U.S. automotive industry was facing with respect to competing in small fuel-efficient cars and the enormous stresses this adjustment placed upon its financial resources and work force. As this Committee well knows, the Japanese Government undoubtedly restrained auto exports also, in an effort to dull the increasing sentiment in the Congress for unilaterally imposed quotas or other restrictions. The Administration welcomed, as did many members of Congress, the Japanese action as a positive contribution to the alleviation of the adjustment problems the domestic automotive industry was then having, but recognized that the real resolution lay in actions that the industry and labor themselves must subsequently take to reduce costs, increase productivity and produce quality products.

Today, over three years later, we find ourselves again examining the necessity for the continuation of the Japanese action and its effects upon the U.S. industry and the U.S. consumer. The Administration has continually monitored the restraints and consulted with the Japanese Government on the changing economic conditions in the domestic industry. The current Japanese restraints are not scheduled to expire until March 1985. Therefore, the Administration has sought no decision by Japan on further restraints. I, nonetheless, welcome the opportunity this hearing affords to look at the present state and the future outlook of the U.S. auto industry.

Before giving my views on the current situation, I would like to take a few moments to describe the condition of the automobile industry, as this Administration found it shortly after coming into office in 1981 and the underlying causes of the industry's problems. I hope this will establish a benchmark for a better understanding.

In 1981, the "big four" auto companies had a combined $7.5 billion negative cash flow from operations and were $13 billion in debt. Unemployment rates in this industry were twice those for the nation as a whole. Sales of domestic cars were 6.2 million units, down by over a third from the peak levels of 1978. Although in absolute terms auto imports in 1981 were only 250 thousand units higher than their level four years earlier,

the fall off in domestic car sales caused import market share to rise to 27 percent and the Japanese share to 22 percent.

With the benefit of hindsight, we can see that the problems of the U.S. industry had been coming for some time.

These problems came to full bloom in 1979, following the oil supply disruptions. The sudden rise in fuel prices and sporadic fuel shortages of that period resulted in a sharp shift in demand from larger cars to smaller fuel-efficient vehicles. U.S. manufacturers were not prepared to meet the swing in demand. High management and labor costs were in place, while quality was not. Unsold imported cars, sitting in inventory previously, were in huge demand. To make things worse, the real cost of buying and operating a car was shooting upward resulting in consumers holding on to their older cars and general decreased sales. Heaped on top of this situation, the entire economy had been slipping into the sharpest recession since World War II resulting in severe declines in the postponable purchases of durable goods -- and particularly automobiles.

The government's role in this situation could not be called positive. Record high interest rates and taxes combined with

record high car prices to suppress car demand. The government had also been sending conflicting signals to the market place by mandating the production of fuel-efficient cars, while simultaneously requiring pollution controls and certain safety standards which reduced fuel efficiency. The results of this over regulation in the auto industry had been to drain off from the capital base very sizeable amounts of money in an effort to meet governmentally-mandated objectives -- many of which had nothing to do with improving the quality or performance of the car in the consumers' eyes -- and raise car prices. (One study estimated that the antipollution regulatory standards, currently applicable, increased costs by $1,400 per automobile).

In order to respond to some of these longstanding problems, this Administration took several actions. A regulatory relief program was established which identified 34 auto industry related regulations which were inefficient in a cost-benefit sense. However, the cornerstone of the President's initiatives on behalf of the industry was his economic recovery program. The President stated, "There is simply no doubt that revitalization of the economy is the single most important remedy for the auto industry's problems." The Administration also welcomed the Japanese export restraints as necessary to restore the confidence in the industry if it were to undertake the steps required to make the transition to smaller fuel-efficient vehicles.

What have been the results of these actions to this date?

First, the industry responded by spending nearly $32 billion for capital improvements from 1981 to 1983 in order to modernize their facilities, improve productivity and bring out new models. To put this figure in perspective, auto industry capital spending as a proportion of sales was about 50 percent higher than in U.S. manufacturing as a whole.

Second, U.S. small car capacity increased from 1.4 million units in 1978 to 3.9 million units in 1983. Output of more fuel efficient 4-cylinder engines with front-wheel drive transaxles increased from less than 10 percent of production capacity to over a third of capacity. And high technology electronics were incorporated to such an extent in automobiles and their manufacture that the auto industry became the electronics industry's number one customer.

Third, changes in many of the government-mandated regulations on the automotive industry have been completed resulting in estimated savings of billions of dollars to the industry and ultimately the consumer.

With recovery of the general economy well underway by the Spring of 1983, and with a cap on Japanese imports, the U.S. auto

industry was well positioned to benefit from increasing auto demand. U.S. car sales in 1983 were up 1.2 million units over 1982 with a whopping 87 percent of this increase going to domestic firms. This resulted in a record nominal profit for the U.S. auto companies of $6.2 billion with a return on sales of 4.54 percent, surpassing the 4.05 percent level reached in 1978 -- what many analysts consider the industry's last good year.

Through the first five months of 1984, the picture looks even brighter. Domestic car sales are up nearly 25 percent from last year. Total car sales this year, imported and domestic, are expected to exceed 10 million units and U.S. corporate auto profits may reach a record $10 billion.

Import market share, which had peaked at monthly levels in excess of 31 percent in 1982, has averaged just over 22 percent through May of 1984. Likewise Japanese import share declined to slightly over 16 percent in this recent five month period.

Employment is, however, the measure of recovery and health which most of us consider of primary importance. Employment among the automobile manufacturers, which had dropped from over 1 million workers in 1978 to less than 700 thousand workers in 1982, was again reaching over 860 thousand workers in May. Also, many of the U.S. auto jobs lost were lost, <u>not</u> to imports, but rather to plant modernization, robotics and the increased

share of small car production. These are jobs that would never have reappeared in the auto plants, regardless of the level of imports, but have reappeared in other industries and sectors. The economy as a whole has generated over 5 million jobs in the last 12 months giving further relief to those displaced from the automotive as well as the auto supplying industries.

But the strong recovery of the last year has a possible down side. Manufacturers and suppliers who cut costs under the pressure of falling domestic sales and import competition may, with bigger profits, be tempted to back away from their stringent managerial practices. Already, we have witnessed very sizeable salary and bonus packages being awarded to auto executives, at a time, when non-market forces are increasing the prices of automobiles. Labor, which was forced by economic necessity to reopen old contracts, could well look at those higher profits and increased executive pay and decide to make comparable compensation gains in the bargaining period approaching this Summer.

Independent analysts have forecast that even with larger profits, the auto manufacturers will be spending in the red over the next few years for capital improvements necessary to stay competitive. With the possibility of higher salary and wage costs, an outside observer might wonder from where the investment funds will come. Without these investments, one

would certainly wonder from where the future auto industry jobs will come.

When the Administration took its special auto action in 1981 and accepted the Japanese voluntary restraints, there was an assumption that those market interventions by government were somewhat justified to counterbalance some of the previous governmental mistakes, that had disturbed the market and diminished the competitive ability of the U.S. auto industry. These actions were designed to lessen the effects of the unusual coincidence of severe structural pressures on the U.S. industry with a downturn in the business cycle. The general economy is now growing; the U.S. auto industry is increasing sales, profits, and employment. This progress is commendable, but the industry cannot abate its efforts. The long term structural problems of this industry have not gone away nor can government make that happen. The industry must respond to challenges, such as saturation of mature markets, increased automation, changes in technology and consumer tastes, higher energy costs and new competitors operating from both foreign and domestic production facilities.

No one, more than I, hopes that both auto executives and workers can be increasingly better compensated for their jobs. However, this compensation cannot be sustained by indefinite trade restraints which increase the price of a car beyond the means of many citizens -- people who make far less than those

who work in the auto industry. That increased compensation must be earned by increased commitment to quality and productivity.

This Administration is committed, along with our major trading partners, to halt protectionism and, as recovery proceeds, to reverse it by dismantling trade barriers. We do not follow this policy based upon an idealistic view of world trade nor of how others in the trading community may sometimes act. Rather, the pursuit of freer trade is a necessity for the continuation of the present economic expansion on a world-wide basis -- and with it, the preservation and growth of American jobs. The situation and needs of the auto industry, as they become clearer over the next several months, must be measured on the same scale as those of consumers and workers in other industries.

We have learned from experience that U.S. industry stays competitive, efficient, profitable, and growing, when it must make the tough decisions and necessary investments that come from a competitive environment. One past mistake was that we have allowed some industries to get fat and lazy. We cannot let this happen again -- for any reason. Our future national well-being depends upon our ability to meet the competition, not be isolated from it.

DATA APPENDIX

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Table I

VALUE OF TRADE IN NEW PASSENGER AUTOMOBILES
(in billions of $US)

Year	U.S. Imports from the World*	U.S. Imports from Japan	U.S. Exports to the World*	Trade Balance
1970	1.373	.456	.114	-1.259
1971	2.737	.929	.124	-2.613
1972	3.111	1.138	.122	-2.989
1973	3.716	1.244	.215	-3.501
1974	4.454	1.686	.347	-4.107
1975	4.198	1.742	.427	-3.771
1976	5.327	2.855	.566	-4.761
1977	6.791	3.860	.637	-6.154
1978	9.583	5.771	.956	-8.627
1979	10.982	6.471	1.323	-9.659
1980	12.877	8.229	.884	-11.993
1981	13.427	9.491	.765	-12.662
1982	14.392	9.608	.517	-13.875
1983	17.459	11.441	.346	-17.113

* Except Canada

Source: U.S. International Trade Commission

Table II
VALUE OF RETAIL SALES OF NEW PASSENGER AUTOMOBILES
(in thousands of Units)

Year	Domestic 1/	Imported 2/	Imports from Japan	Total
1968	8,418	960	113	9,378
1969	8,385	1,044	191	9,429
1970	7,157	1,261	313	8,418
1971	8,263	1,541	552	9,804
1972	8,958	1,592	615	10,550
1973	9,631	1,753	742	11,385
1974	7,332	1,409	597	8,741
1975	7,050	1,580	817	8,630
1976	8,607	1,499	938	10,106
1977	9,104	2,069	1,388	11,174
1978	9,308	1,976	1,337	11,284
1979	8,225	2,304	1,749	10,530
1980	6,578	2,363	1,882	8,941
1981	6,206	2,327	1,859	8,533
1982	5,757	2,223	1,798	7,980
1983	6,795	2,386	1,877	9,182
1984				
Jan	538	195	147	789
Feb	655	186	139	841
Mar	756	207	152	964
Apr	721	174	118	896
May	803	244	183	1,047
1983 YTD	2,666	980	781	3,646
1984 YTD	3,519	1,008	739	4,527

Source: Ward's Automotive Reports

1/ Domestic automobile sales include U.S. and Canadian built automobiles sole in the United States.
2/ Does not include automobiles imported from Canada.

Table III
VALUE OF TRADE IN MOTOR VEHICLE PARTS
(in millions of $US)

Year	U.S. Imports from the World*	U.S. Imports from Japan	U.S. Exports to the World*	Trade Balance
1979	7.289	3.356	5.503	-1.786
1980	8.043	3.690	6.756	-1.287
1981	7.485	2.897	7.910	.425
1982	6.986	2.670	6.867	-.119
1983	7.753	2.643	5.569	-2.184
1983 YTD	2.286	.808	1.854	-.432
1984 YTD	3.503	1.250	2.078	-1.425

* Except Canada

Source: International Trade Commission

Table IV
VALUE OF TRADE IN AUTOMOBILE TRUCKS 1/
(in millions of $US)

Year	U.S. Imports from the World*	U.S. Imports from Japan	U.S. Exports to the World*	Trade Balance
1970	2.853	.116	172.633	169.780
1971	28.943	26.432	163.575	134.632
1972	117.448	116.594	158.757	41.309
1973	60.863	59.147	202.675	141.812
1974	40.993	40.466	298.533	257.540
1975	5.385	5.160	924.255	918.870
1976	1.093	.894	715.560	714.467
1977	1.048	.955	691.876	690.828
1978	1.828	1.385	919.755	917.927
1979	25.580	25.341	909.577	883.997
1980	375.866	375.726	1,143.118	767.252
1981	1,816.782	1,811.977	1,208.221	-608.561
1982	1,507.934	1,486.753	1,263.000	-244.934
1983	1,763.280	1,755.177	644.049	-1,119.231

*Except Canada

1/ Data includes lightweight cab/chasis which were reclassified as unfinished trucks (692.02) during 1980 by the U.S. Customs Service.

Source: U.S. International Trade Commission

Table V

U.S. EMPLOYMENT

ANNUAL AVERAGE FOR THE
MOTOR VEHICLES AND EQUIPMENT INDUSTRY
(In Thousands)

	Employment
1972	874.8
1973	976.5
1974	907.7
1975	792.4
1976	881.0
1977	947.3
1978	1004.9
1979	990.4
1980	788.8
1981	783.9
1982	690.0
1983	757.8

U.S. EMPLOYMENT

MONTHLY FIGURES FOR 1983 AND YEAR-TO-DATE 1984
FOR THE MOTOR VEHICLES AND EQUIPMENT INDUSTRY
(In Thousands)

1983	Jan	668.5
	Feb	695.7
	Mar	707.1
	Apr	724.3
	May	744.1
	Jun	753.6
	Jul	755.9
	Aug	750.4
	Sep	801.9
	Oct	824.4
	Nov	831.6
	Dec	835.6
1984	Jan	833.3
	Feb	852.1
	Mar	863.0
	Apr	855.0*
	May	863.4*

*These figures are preliminary.

Source: Bureau of Labor Statistics

Table VI

U.S. EMPLOYMENT

ANNUAL AVERAGE FOR
ALL MANUFACTURING INDUSTRIES
(In Millions)

	Employment
1972	19.15
1973	20.15
1974	20.08
1975	18.32
1976	19.00
1977	19.68
1978	20.50
1979	21.04
1980	20.29
1981	20.17
1982	18.85
1983	18.50

U.S. EMPLOYMENT

MONTHLY FIGURES FOR 1983 AND YEAR-TO-DATE 1984
FOR ALL MANUFACTURING INDUSTRIES
(In Millions)

1983	Jan	17.87
	Feb	17.88
	Mar	17.96
	Apr	18.09
	May	18.27
	Jun	18.51
	Jul	18.46
	Aug	18.71
	Sep	18.97
	Oct	19.05
	Nov	19.09
	Dec	19.09
1984	Jan	19.03
	Feb	19.18
	Mar	19.32
	Apr	19.43*
	May	19.54*

*These are preliminary figures.

Source: Bureau of Labor Statistics

Table VII

UNITED STATES UNEMPLOYMENT
(Percent)

	All Civilian	Manufacturing	Auto Manufacturing
1972	5.6	5.6	4.4
1973	4.9	4.3	2.4
1974	5.6	5.7	9.3
1975	8.5	10.9	16.0
1976	7.7	7.9	6.0
1977	7.0	6.7	3.9
1978	6.0	5.5	4.1
1979	5.8	5.5	7.5
1980	7.1	8.5	20.3
1981	7.6	8.3	14.6
1982	10.8	14.8	23.0
1983	9.6	11.2	12.6
1984 Jan	8.0	8.4	6.4
Feb	7.8	7.5	5.4
Mar	7.8	7.5	5.8
Apr	7.8	7.7	6.3
May	7.5	7.1	8.0

UNITED STATES UNEMPLOYMENT
MONTHLY RATES FOR 1983 AND YEAR-TO-DATE 1984
FOR THE AUTO MANUFACTURING INDUSTRY
(In Percent)

1983	Jan	16.9
	Feb	16.9
	Mar	15.5
	Apr	15.8
	May	14.7
	Jun	13.9
	Jul	10.7
	Aug	10.3
	Sep	11.3
	Oct	10.7
	Nov	9.4
	Dec	5.5
1984	Jan	6.4
	Feb	5.4
	Mar	5.8
	Apr	6.3
	May	8.0

Source: Bureau of Labor Statistics

Senator DANFORTH. Next we have a panel: Robert Miller, executive vice president, finance and administration, Chrysler Corp.; Mr. Whipple, vice president, corporate strategy and analysis, Ford Motor Co.; and Dr. Marina V. Whitman, vice president and chief economist, General Motors Corp.

Mr. Miller.

STATEMENT OF ROBERT S. MILLER, EXECUTIVE VICE PRESIDENT, FINANCE AND ADMINISTRATION, CHRYSLER CORP., DETROIT, MI

Mr. MILLER. Thank you very much, Mr. Chairman.

My name is Steve Miller. I am executive vice president for finance and administration for the Chrysler Corp. I would like to add that I have been in the industry for 16 years—11 of those were with the Ford Motor Co. where I spent 8 years living overseas, primarily in the Far East and in Latin America. I am also director of a small family lumber business in Oregon whose primary export customer is Japan, so I think I bring to this committee some perspectives beyond just Detroit.

If I am to summarize from my paper where the American auto industry is today, I would say that we have seen some light but we're certainly not out of the woods yet. Chrysler's record for the past 5 years is still a large net loss. Contrary to conventional wisdom, we have succeeded in the past couple of years largely because we became more efficient. Our productivity at Chrysler has increased by more than 50 percent in the last few years, our quality is better, and we have improved the fuel efficiency of the cars that we make. And of course, the Nation's economy has improved. People have not only started buying cars again in larger numbers, but they are buying them loaded with more options. In other words, instead of selling hamburger, we're now selling steak.

To remain competitive, however, Chrysler alone is planning to invest more than $9 billion in new plants and retooling over the next 5 years. But if the Japanese continue to enjoy a $1,600-per-car unfair advantage, thanks to tax policies and currency imbalances already discussed here this morning, then our investment and our quality won't matter much, and America's auto industry and future economic growth are in danger.

Three years ago the administration agreed to support voluntary restraints on Japanese imports to give us time to address three main problems: First, the value of the yen; second, the problem of tax systems; and, third, to give the American auto industry time to get back on its feet.

Now, unfortunately, most of the recent debate has forgotten all that and has merely focused on prices, profits, and pay. Those subjects certainly grab headlines, but they don't capture the reality of the auto industry's current condition.

The facts are these: During the first 3 years of voluntary restraints, the price of Chrysler's small cars, the ones that go head-to-head with the Japanese, went up just 3 percent, or 1 percent a year. That's far less than the Consumer Price Index, which went up 17 percent during the same period and which affected many of the parts we put into our cars.

Now, if we eliminate restraints this coming April, what is going to happen? By 1986 we estimate that Japan will be selling 3 million cars a year in the United States. If the restraints are not continued until we have a chance to address the unfair tax and trade and currency advantages of Japan, then Chrysler will be forced to follow General Motors in abandoning small car production in America and taking our jobs offshore. If that happens, by 1986 the U.S. companies themselves could be importing over 600,000 cars a year, and that number could go over a million cars a year by the end of the decade. That's a lot of cars, and it's a lot of jobs. By 1988, as many as 300,000 jobs in America's auto industry could disappear, and that could add $28 billion a year to a Federal budget already drowning in red ink.

Now, during the restraint program Nissan and Honda have invested over a billion dollars in new plants in Tennessee and Ohio, and they are planning expansions. But removing restraints would remove the incentives for their investment.

Now, the recent agreements on internationalizing the yen represent a step in the right direction, but the agreement will mean little as long as the value of the dollar continues to be boosted by high interest rates resulting from Federal budget deficits. And unfortunately we have seen no action yet on the Japanese tax advantage problem.

Lifting voluntary restraints before resolving the tax and currency problems would be a grave mistake. Last year our trade deficit with Japan totaled $20 billion, 75 percent of which came from automobile trade. That deficit is going to $30 to 40 billion this year, and if you then consider the impact of an additional 1 million Japanese cars a year, that adds $10 billion in the automotive sector alone to our trade balance problem.

At Chrysler, we bounced back from adversity by bringing everyone—business, labor, and Government—to the table and asking everyone to do their share to revitalize the company. My chairman, Lee Iacocca, proposes a compact for automotive revitalization based on the same principle of equality of sacrifice. If the Government agrees to level the international playing field by aggressively addressing the yen-dollar imbalance and tax differentials, then Chrysler would agree to freeze prices on its American-built small cars indefinitely, and would reasonably restrain our executive bonuses. Under Mr. Iacocca's proposal, we are also offering to freeze the outsourcing, the purchases of foreign-made car components, at their current level, if the United Auto Workers agrees to cooperate with us in finding ways to meet the challenge of foreign competition.

What we are saying is, it's time for everyone to sit down together and work out a strategy for promoting economic growth and increasing the number of American jobs.

We do not claim that continued restraints will answer all of our problems, but we see them as an important and necessary step, moving the auto industry to the point where we can say we are back and standing tall, and not just for this year but for years to come.

I thank the members of the committee for my time here.
Senator DANFORTH. Thank you, sir.
Mr. Whipple.
[Mr. Miller's prepared statement follows:]

Statement by R.S. Miller, Jr., Executive Vice President - Finance, Chrysler Corporation, to the U.S. Senate Finance Committee Subcommittee on International Trade, Washington, D.C., June 27, 1984

Thank you, Mr. Chairman. My name is Steve Miller, and I am the executive Vice President for Finance and Administration for the Chrysler Corporation.

Mr. Chairman, you've called these hearings to determine where the American auto industry stands today, and where it is going in the future.

If I were to summarize where the American auto industry is today, I would say that we have seen some light -- but that we are not out of the woods yet.

All of you remember the days when Chrysler came within inches of going under. Even though we've broken into the black recently, Chrysler lost nearly 3 1/2 billion dollars from 1978 through 1981 . That means that we still have to earn more than 1.9 billion dollars before breaking even.

Contrary to conventional wisdom, we've succeeded in the last few years largely because we became more efficient. At Chrysler, our productivity increased more than 50 percent. At Chrysler, our quality increased -- so that last year, our safety recalls totalled just over 7,000 cars, compared to more than a million each by our American competitors and by the Japanese companies combined. We also improved fuel economy. In fact, we are the only American automaker to meet the corporate standards.

And, of course, the economy improved. People not only started buying cars again -- but they started buying cars loaded with more options. Instead of settling for hamburger, they've chosen steak.

But all that is history, and what we need to do now is focus on the future. To remain competitive, Chrysler alone must invest $9 billion in new plants and reetooling over the next five years. If we make that investment, I have no doubt our

products will continue to be equal to -- if not better than -- anything made anywhere in the world today. But if the Japanese continue to enjoy a $1,600 per car advantage, thanks to their tax policies and currency imbalances, then our investment -- and our quality -- won't matter much, and America's auto industry and future economic growth could be endangered.

Three years ago, the Administration agreed to support voluntary restraints on Japanese imports to give us time to address three fundamental problems. Voluntary restraints were never proposed as a long-term solution. All they were designed to do was to buy time until we accomplished the following goals:

First, to bring the value of the yen and the value of the dollar into line.

Second, to redress the unfair Japanese tax system, which encourages firms to export automobiles to America.

Third, to give the American auto industry time to get back on its feet.

In the last three years, the American auto industry has bounced back -- along with the rest of our economy.

Unfortunately, most of the recent debate over the state of the American auto industry has focused on three subjects: prices, profits and pay. Those subjects may grab headlines -- but they don't capture the reality of the auto industry's current condition.

Most of you are probably familiar with the studies claiming that the Voluntary Restraint Agreement with Japan has allowed Detroit to gouge prices, inflate profits, and line executive pockets with big bonuses. One widely reported study charged that as much as $1,000 -- or 40 percent -- of the increase in the average price of a new car was -- and I quote -- "due directly to the inflationary impact of the voluntary limit on Japanese shipments."

That study -- funded entirely by the Japan Auto Manufacturers Association -- and others like it simply do not paint an accurate picture of what's happened in the

American auto industry over the last three years. In fact, one of the authors of the study has since admitted that the $1,000 figure was in error.

The facts are these. During the first three years of voluntary restraints, the base price of American cars increased 12 percent. Chrysler's prices went up 11 percent during that period -- and the prices of our small cars -- the ones that go head to head with the Japanese -- went up only 3 percent, or just one percent a year. Yes, prices have increased. But the Consumer Price Index increased 17 percent -- or almost 50 percent more than car prices -- during the three years of voluntary restraints.

If we eliminate restraints this coming April, what will happen?

By 1986, Japan will be selling 3 million cars a year in the United States. At Chrysler, we have plans to invest $600 million to build a new small car in America -- and we'd like nothing better than to see those plans go through. But if restraints are not continued until Japan's unfair tax, trade and currency advantages have been addressed, we will be forced to follow General Motors in abandoning American small car production and going offshore. If that happens, by 1986 the U.S. companies themselves will be importing 600,000 cars a year -- and that figure could go well over a million in succeeding years.

That's a lot of cars -- but more importantly, it's a lot of jobs. By 1988, as many as 300,000 jobs in America's auto industry could disappear. According to a recent study by your own Congressional Budget Office, those job losses would add nearly $28 billion to a federal budget already drowning in red ink. And that says nothing about what it will cost state and local governments in unemployment compensation, food stamps, or other forms of assistance -- or about what will happen to the auto industry's suppliers. It's not only the steel, rubber, paint or textile industries that would be affected, but also the high-technology industries.

After the military, GM, Ford and Chrysler are the high-technology industry's three biggest customers.

Let me add that solely because of restraints, Nissan and Honda invested nearly $1.2 billion in new plants in Tennessee and Ohio. Both are planning major expansions --but removing restraints also removes their investment incentive.

The recent agreement on the value of the dollar and yen represents a step in the right direction -- but it is only a step. We applaud Secretary Regan's accomplishment -- but we're realistic about its potential. It may be years before the agreement fulfills its promise. In fact, in the few weeks since it was announced the yen has weakened further. The agreement means little as long as the value of the dollar is boosted by the federal budget deficit.

Unfortunately, we've seen no action on the Japanese tax advantage -- except for the Japanese increasing their commodity tax recently, giving Japanese producers even more of an incentive to export. Even Bill Brock admitted last month that lifting voluntary restraints before resolving both the tax and currency problems would be a grave mistake -- and that's one issue on which the Special Trade Representative and the Chrysler Corporation agree.

Mr. Chairman, we at Chrysler have never seen protectionism as the answer to the auto industry's present or future problems. While we are sympathetic to its goals of leveling the international playing field and keeping auto production in this country, we oppose domestic content legislation. From my experience in the international auto industry, I can tell you that domestic content legislation simply doesn't work. Argentina has had domestic content laws for years, but they don't have a healthy domestic auto industry. They do have a lot of debts -- but so do we. And I am afraid that if we let the voluntary restraints lapse, our budget and trade deficits will only increase.

Last year, our trade deficit with Japan totalled $20 billion. 75 percent of that stemmed directly from trade in automobiles. According to Paul Volcker, that deficit will expand to $30 or $40 billion this year, even with restraints. Remove the restraints, and at least another 1.1 million Japanese cars will flow into the country. That will increase our trade deficit by at least another $10 billion annually in the automotive sector alone.

Now, I know many of you have expressed your concern that if we continue restraints, we run the risk of Japanese retaliation. But I think we ought to look at Japan's trade relations with some other countries. Canada and Australia both hold Japanese imports to tolerable levels -- and both have positive balances of trade with Japan. Australia not only enforces import quotas, but they impose high duties and restrict their market to five companies only. Not only have the Japanese not retaliated -- they haven't even mentioned the matter in negotiations or public statements.

The European nations are even more restrictive, but the situation is the same. The Japanese simply haven't retaliated. The truth is, even with American restraints at current levels, the Japanese are reaping tremendous profits in our market. I find it hard to believe that they'd find more profits of that size to be unacceptable.

At the Chrysler Corporation, we bounced back from adversity by bringing everyone -- business, labor and government -- to the table, and by asking everyone to do their part in revitalizing the company. Our chairman, Lee Iaccocca, has proposed a Compact for Automotive Revitalization based on the same principle of equality of sacrifice. If government agrees to level the international playing field by aggressively addressing the yen/dollar imbalance and tax differentials, then Chrysler will freeze prices on its American-built small cars immediately, and we would severely limit our executive bonuses.

Under Mr. Iaccocca's proposal, Chrysler is also offering to freeze purchases of foreign-made car components at their current level if the UAW agrees to cooperate in finding ways to meet the challenge of foreign competition.

We're not suggesting that this is precisely the plan that we should follow, and we're certainly open to any and all suggestions. But we are saying that it's time for everybody to sit down together -- to work out a strategy for promoting economic growth and increasing the number of American jobs.

UAW President Owen Bieber has already responded favorably to Mr. Iaccocca's invitation to work out a plan -- but we can't do the job that needs to be done without your help. Only government can make sure the yen/dollar agreement lives up to its promise. Only government can attack the tax differential problems. Only government can make sure the restraints stay in place until these fundamental problems are solved. And only government can foster the right kind of attitude among all parties as we enter into critical negotiations which will set wage patterns for a whole host of American industries.

Mr. Chairman, we do not claim that continued restraints will answer all our problems. But we do see them as an important and necessary step toward moving the auto industry to the point where we can say we are back, and standing tall -- not just this year, but for years to come.

Again, I want to thank the members of the committee for giving me this opportunity to testify, and I will be happy to answer any of your questions.

STATEMENT OF KENNETH WHIPPLE, VICE PRESIDENT, CORPORATE STRATEGY AND ANALYSIS, FORD MOTOR CO., DEARBORN, MI

Mr. WHIPPLE. Thank you very much, Mr. Chairman.

I will also summarize from the paper that we submitted. I will cover the three points that you asked us about, the state of the auto industry now, the effects of the export restraint program, and then the outlook for auto trade in the future.

We are recovering from the prolonged downturn, there is no question about that. Despite the record losses in this period, all of the U.S. producers invested heavily in the future. In fact, I don't think it is too strong to say that never before in peacetime has another major industry come even close to accomplishing what has been accomplished in our industry in the last 3 or 4 years.

At Ford, just to tick off a few examples, our car quality is up 55 percent in this period. We invested $10 billion in new products, and we also invested $7 billion in research and development. We cut annual operating costs by $4 billion. The bottom line to all of that is we've become profitable, we've reduced our debt that we had to increase substantially in this period by nearly $1 billion, and we have raised our share in the market by about 2 percentage points.

Export restraint is playing a role in this recovery, particularly during the past year. It is helping to shift some would-be buyers of Japanese cars to United States products, and to assure that the jobs from recovery go to United States workers and not to workers in Japan.

It has also discouraged Japanese producers from taking advantage of the rate, the misalignment in exchange rates.

To be sure, restraints have had some effects on availability and prices of Japanese cars; but I think it is important to remember that plenty of fully-competitive United States built cars have been available in this period, and price increases on these United States cars, as Mr. Miller said, have been moderate by any standard. Further, there have been substantial offsetting benefits to U.S. taxpayers and the economy—in jobs, in tax revenues from rehired autoworkers, and decreased welfare costs.

Looking to the future, we see major opportunities for the industry and for the suppliers to our industry. But the Japanese are also setting their sights on these opportunities. Here are a couple of facts that we haven't discussed here this morning:

The Japanese have put in place a manufacturing capacity of some 13 million cars and trucks—for a home market in which they sell only 5 million cars and trucks. That creates enormous pressure to export, pressure increased by unused capacity that we estimate at about 2 million units. The result is that the United States is the inevitable target of this export capacity, because the rest of the world already limits Japanese auto imports in one way or another. The United States, in fact, already provides a major share of Japanese auto jobs and Japanese auto profits.

The real question for the future is where the bulk of the products will be produced to meet the future demand for the American market—here? Or someplace else?

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Japan's weak currency, a tax system that encourages exports, high productivity and relatively low wages all combine to give Japanese production its present substantial cost advantage compared with the United States.

Some U.S. producers have already moved to take advantage of these conditions; all of us in the business are forced to consider these decisions every day.

Two things can change these economic facts of life, that otherwise will lead to more imports and fewer U.S. jobs.

First, industry must act to further improve our competitiveness. We believe the record demonstrates that Detroit has accepted this challenge and has made substantial progress, and we are not going to relax in that effort.

But industry can't fix the yen-dollar imbalance, and industry can't fix the budget deficit or the trade deficit, either. That's up to Government.

So Government policy is in fact critical to the outlook for U.S. production.

The United States could work with other governments to equalize the conditions of trade and to provide a reasonable balance of jobs and production. This means recognizing that, like it or not, there really isn't any free auto trade in the world today. Until the conditions of trade can be equalized, the United States Government could encourage foreign producers to locate in this country, or support continued Japanese auto restraints. If the Government doesn't take any action, however, there is a very real question as to whether it will continue to make economic sense to make cars in this country.

A no-action approach represents a much greater risk to the country than to any of our companies. U.S. manufacturers already know how to utilize low-cost sources—we at Ford are a global company and have been that way for a many years—if we are forced to do so. But our preference is to continue to produce in the United States and provide jobs in the United States.

It is in everyone's interest to work out a way to retain this country's largest manufacturing industry and the American jobs it supports. Thank you, Mr. Chairman.

Senator DANFORTH. Thank you.

[Mr. Whipple's written testimony follows:]

STATEMENT OF KENNETH WHIPPLE
VICE PRESIDENT, FORD MOTOR COMPANY
BEFORE THE SENATE FINANCE COMMITTEE
SUBCOMMITTEE ON INTERNATIONAL TRADE
June 27, 1984

We welcome the Committee's continuing interest in auto trade issues. It's a good time to review the situation and to assess the challenges for the future.

The U.S. auto industry is in a state of recovery. An unprecedented market downturn was compounded by the need for record investments to meet new regulatory requirements and abruptly changed U.S. energy conditions. These energy conditions created an overnight demand for the kinds of cars that Japan was producing and for which there had been little U.S. demand. To revitalize itself, the U.S. auto industry has undertaken unparallelled actions. At Ford, for example:

- The quality of our 1984 model cars is 55% better than four years ago (trucks improved 59%). They are better than the average car sold in America -- wherever produced -- and gaining substantially on the best cars produced in the world.
- During the downturn, we invested $10 billion in new high technology products and machinery, despite losses of $3.3 billion. We also spent $7 billion on R&D.
- We've reduced annual operating costs by $4 billion, which permitted a return to profitability even with modest volume recovery.
- Last year, we introduced more new products than any time in our history.

- We forged a new labor/management relationship and changed our management structure to eliminate layers and increase spans of control.
- The bottom line is that these efforts are paying off. We've returned to profitability. We've reduced our debt by nearly $1 billion. And we've raised our car market share by close to 2 points.

Never before in peacetime has a major industry accomplished such a dramatic and rapid turnaround.

The Japanese voluntary restraint agreement (VRA) has also played a role in industry recovery, particularly in the past year. Japanese sales were not effectively limited during the first two years of restraints because overall auto demand was declining. But as industry demand recovered, the VRA helped shift some would-be buyers of Japanese cars to U.S. products. It also has been important in discouraging the Japanese from taking advantage of the distortion in currency values to exploit the U.S. market. The currency imbalance actually worsened during the restraint period, as the yen weakened from a rate of 211 per dollar when restraints began to an average rate of 230 this year.

There is no question that the VRA has provided an important element of stability in this economic environment. Nevertheless, the major factors in the U.S. industry's recovery were the cost cutting, the resulting reductions in breakeven volume, and a shift in customer demand to the larger car segments.

To be sure, the VRA has had some downside effects in certain areas. As intended, availability of Japanese products has been recently restricted, which has caused delays in retail deliveries. Also, there probably were increases in the effective retail prices of

Japanese cars that otherwise might not have occurred. It is important to remember, however, that competitive U.S. products have been readily available throughout the restraint period. Moreover, price increases on these U.S. small cars have averaged 2% per year since the VRA began -- less than half the nation's overall rate of inflation. The sticker prices of our most popular Escort models, for example, are lower today than they were in 1982.

While the VRA has had some adverse impacts on buyers who chose Japanese cars, there have been substantial offsetting benefits to U.S. taxpayers and to the U.S. economy as a whole. As auto demand recovered from 1982 lows, the jobs from recovery went to U.S. workers -- some 100,000 laid off auto workers are back on the job and that doesn't count the jobs in auto supplier and support industries. The fact that these workers are now paying taxes instead of drawing unemployment checks helps all of us. Every car produced in the United States generates about $1500 in U.S. tax revenues -- taxes that would have to be collected from other taxpayers if the car were imported.

Looking to the future ... we see major opportunities for the industry and its suppliers. That is why we are continuing and stepping up the aggressive programs on quality, productivity, fuel economy and technology.

But we are not alone. The Japanese also are setting their sights on these opportunities. They have a home market of about five million cars and trucks -- and they have purposefully built a manufacturing capacity of 13 million, with unused and available capacity of two million units. So there is great pressure to export. And because the rest of the world has set up barriers and limits or restraints of one sort or another, their target market must be the U.S. As a nation, the

United States is a major provider of auto jobs in Japan and generates a major share of the profits earned by Japanese automotive companies. In fact, most of the profits in today's world auto market are earned on sales right here in the U.S. It clearly is not in our interest as a country to export the profits and jobs that result from our sales.

The question for the future is where will the products be produced to meet the future demand of the American market -- here or elsewhere? Countries like Japan will continue to be very attractive places to produce automobiles. Why? -- in Japan's case, it's because of a weak currency and a tax system that encourages exports. These combine with high productivity and relatively low wage rates to yield a Japanese cost advantage that is generally estimated to be about $2000 per car. Some U.S. producers already have chosen to take advantage of these conditions by contracting for substantial volumes of Japanese cars for sale in the U.S. All of us in the industry are forced to face similar choices every day.

How can we change these economic facts of life that will otherwise lead to increased imports and a decline in U.S. production? There are two sets of challenges -- one for the private sector and one for the public sector. Washington has told Detroit to get its act together. We understand and accept this challenge. The record demonstrates that we have made substantial progress. Further, we are committed to maintaining this progress with continuing improvements in products, technology, quality and operating efficiency.

But the competitive challenge for the U.S. auto industry is a part of an even larger problem -- the competitiveness of the United States in a world economy. For eight consecutive years, the U.S. has suffered large and escalating trade deficits -- a situation without precedent in

our history. Last year, the deficit was over $60 billion, $24 billion of which was accounted for by autos and auto parts. This year's deficit is running at a rate of well over $100 billion/year.

Much of this deficit reflects currency distortions, which hurt U.S. exporters and companies competing with imports. The currency distortions are being driven by high U.S. interest rates and record U.S. budget deficits, which simply must be curbed if we're to be competitive as a nation.

If not corrected, the yen/dollar imbalance alone will keep the industry from attaining its goal of world competitive costs for U.S. production because it gives Japan an unearned $600-$800 cost advantage on each car produced. And as much as we'd like to, the industry itself can't fix the yen/dollar imbalance. And we can't fix the budget deficit or the trade deficit either. That's government's responsibility.

We believe there are three possible courses for government policy:

- First, the U.S. could work with other governments to equalize the conditions of trade. There really is no such thing as free trade for autos today. We wish that were not the case, but most countries decided long ago that auto production is too important for their economies and employment and manufacturing bases to let it slip away. As a nation, we could decide to accept today's auto trade situation as a reality and try to work out a way to assure a reasonable balance in jobs and production with our major trading partners.
- Second, if the conditions of trade cannot be equalized -- or until they can -- the U.S. government could act by encouraging foreign

producers to locate in this country or by supporting the continuation of Japanese auto export restraint.

Third, the U.S. government could take a no-action approach. In this case, we believe the risk will be greater to the nation than to individual auto companies. The auto industry is the steel industry's biggest customer and we purchase 20-25% of the nation's machine tools, and more than 60% of its rubber. The industry has been a major force for adapting high technology to volume production. The industry also knows how to utilize low cost offshore sources to achieve the most economic production if forced to do so. Our preference is to continue to produce and provide jobs in the U.S. If the U.S. takes no action, there is a very real question as to whether it will continue to make economic sense to manufacture cars in this country.

Mr. Chairman, we wish we could tell you that the solutions to competitive U.S. auto production are all within our control, but they are not. And the implications for the U.S. industry, its workers, the industries it supports and the nation's economy and industrial base are simply too large to ignore. It is in everyone's interest to work out a way to retain the country's largest manufacturing industry and the American jobs it supports.

Senator DANFORTH. Dr. Whitman.

STATEMENT OF DR. MARINA v.N. WHITMAN, VICE PRESIDENT AND CHIEF ECONOMIST, GENERAL MOTORS CORP., DETROIT, MI

Dr. WHITMAN. Thank you, Senator.

I am Marina Whitman, vice president and chief economist for General Motors Corp. I appreciate this opportunity to discuss our views on the questions that you have posed to us today.

The auto industry worldwide is intensely and increasingly competitive. In the past decade U.S. firms have confronted a variety of serious challenges including the energy crisis, inflation, recession, a great increase in Government regulation, and rapid shifts in consumer preferences between smaller and larger cars. All of these elements contributed to a period of rapid change and education for everyone involved in the manufacture of automobiles.

And the competitive challenges are not yet behind us. Perhaps the most significant challenge in recent years has been the emergence of Japan as the world's low-cost producer of passenger cars. We all know the Japanese are efficient producers. During the 1970's, they gained the ability to build small cars and ship them to the United States at costs far below those of domestic automakers. A number of published studies indicate Japanese producers currently enjoy a landed cost advantage for their small cars of between $1,500 and $2,000 per vehicle. And I might add that our own internal assessments suggest this is the case even at what most experts consider to be equilibrium-exchange rates. That is, there is an additional cost disadvantage of some magnitude the further the exchange rate is away from what seems to be a longer run equilibrium relationship.

This cost advantage has been a formidable competitive obstacle. This became especially clear to us during a 1981 small car project, which we called the S car project during its development stages. The S car would have been introduced as a 1984 model; however, we could not at that time find ways to reduce the cost of producing the S car enough to enable us to price it competitively against imports of comparable size and quality.

Out of the S car project grew the establishment of our Saturn project and our joint manufacturing venture with Toyota. Both are critical to the continued competitiveness of General Motors and the job security of our employees. In different ways, each activity will contribute to our ability to produce a cost-competitive small car in the United States

Saturn is our most far-reaching vehicle project ever. Over 300 employees are assigned to this project—more than any other car project in our history. Unconstrained by an introduction deadline, the Saturn team is examining every aspect of vehicle production with a fresh eye to see how costs can be reduced while improving product quality and efficiency and increasing job satisfaction. It is because of the seriousness and long-term importance of Saturn that it has a no-year, no-deadline approach. Saturn is marked also by unprecedented involvement of workers and the UAW in all of its aspects. These cars and the innovation they represent in integrated design, engineering, manufacturing, assembly, materials manage-

ment and human relations will be an historic step toward overcoming the Japanese cost advantage in small cars. Furthermore, we fully expect Saturn's advances to spread throughout our entire product line—many even before the vehicle itself is in production.

Our joint manufacturing venture with Toyota will also provide an important learning opportunity. An especially important aspect is the hands-on experience that the joint venture is already beginning to provide in tailoring Japanese techniques to the U.S. environment. Again, these are techniques we hope and expect can be applied to our other operations, and that will increase our competitiveness across the board.

While the joint venture will produce 200,000 competitive small vehicles in Fremont, CA, we believe the U.S. market has created demand for a great many more small cars than we could supply our dealers for some time. Thus, while Saturn is under development, we plan to increase our small car supply by some imports.

Such supply arrangements are not a new phenomenon. We did it with small trucks in the 1970's until we were able to build a good, competitive small truck here—which we now do. Chrysler, of course, has imported large numbers of passenger cars and trucks; Ford has imported cars and trucks; as have Renault/AMC, Volkswagen.

The voluntary restraint program instituted in 1981 has not muted our efforts to increase our competitiveness. We have maintained a costly program of investment in new products and plants, including two all new Green field plants in the United States. And a third one is currently being readied. We have held price increases on our new cars to significantly less than overall inflation and significantly less than the increased costs of our input. Furthermore, we have held small car prices almost unchanged. Thus, at GM the restraints have always been viewed as temporary.

The bottom line is simple. Today, no automobile company is an island. Increasingly, companies like GM will be cooperating with other companies around the world to find the best, most efficient and effective ways of building products to provide their customers with best value at lowest cost. Such managerial flexibility is crucial to the ability or U.S. producers to participate effectively in the fiercely competitive, worldwide auto industry. Unless American companies are able to trade and invest freely, and cooperate with foreign partners for mutual benefits, both the competitiveness of the U.S production base and the competition-stimulated efficiency of the worldwide industry as a whole will suffer, and so will American employment and economic well-being.

The alternatives to the successful achievement of such global competitiveness would be a choice between increasing shrinkage of U.S.-based production and employment and long-term protection, with its attendant costs and inefficiencies and its ultimate ineffectiveness if we don't get competitive. A competitive U.S. auto industry, on the other hand, will provide the widest choices and best values to consumers and, at the same time, more secure and rewarding employment—not only for the employees of the auto industry itself but for those in all of the other industries dependent for their own health on ours.

Thank you, Mr. Chairman.

Senator DANFORTH. Thank you.
[Dr. Whitman's written testimony follows:]

STATEMENT OF GENERAL MOTORS CORP. PRESENTED BY DR. MARINA V.N. WHITMAN

I am Dr. Marina v.N. Whitman, vice president and chief economist for General Motors Corporation. I am pleased to have this opportunity to discuss our views on auto trade.

The auto industry worldwide is intensely and increasingly competitive. In the past decade U.S. firms have confronted a variety of serious challenges, including: the energy crisis, inflation, recessions, a great increase in government regulation and rapid shifts in consumer preference between smaller and larger cars. All of these elements contributed to a period of rapid change and education for everyone involved in the manufacture of automobiles.

And the competitive challenges are not yet behind us.

Perhaps the most significant challenge in recent years has been the emergence of Japan as the world's low cost producer of passenger cars. We all know the Japanese are efficient producers. During the 1970s, they gained the ability to build small cars and ship them to the U.S. at costs far below those of domestic automakers. A number of published studies indicate Japanese producers currently enjoy a landed cost advantage for their small cars of between $1,500 and $2,000 per vehicle.

This cost advantage has been a formidable competitive obstacle. This became especially clear to us during a 1981 small car project -- dubbed the "S" car project during its developmental stages. The "S" car would have been introduced as a 1984 model however, we could not, at that time, find ways to reduce the costs of producing the "S" enough to enable us to price it competitively against imports of comparable size and quality.

Out of the "S" car project grew the establishment of our Saturn Project and joint manufacturing venture with Toyota. Both are critical to the continued competitiveness of General Motors and the job security of our employes. In different ways each activity will contribute to our ability to produce a cost competitive small car in the U.S.

Saturn is our most far reaching vehicle project ever. Over 300 employes are assigned to this project -- more than any other car project in GM's history. Unconstrained by an introduction deadline, the Saturn team is examining every aspect of vehicle production with a fresh eye to see how costs can be reduced while improving product quality and efficiency and increasing job satisfaction. The seriousness and long-term importance of the Saturn Project is reflected in its unusual no-deadline approach. This project is also marked by unprecedented involvement of workers and the UAW in all aspects of creating the vehicles and the environment in which they are to be built. These cars and the innovation they represent in integrated design, engineering, manufacturing, assembly, materials management and human relations will be an historic step toward overcoming the Japanese cost advantage in small cars and we fully expect Saturn's advances to spread throughout our entire product line -- many even before the vehicle itself is in production.

The GM/Toyota joint manufacturing venture -- New United Motor Manufacturing Inc. (NUMMI) -- will provide us an important learning opportunity. An especially important aspect of NUMMI is the invaluable "hands on" experience it is already beginning to provide in tailoring Japanese small car assembly and management techniques to the U.S. environment. These are techniques that we hope and expect can be applied

to our other operations and that will help us to produce vehicles domestically at costs competitive with the Japanese, thus keeping jobs in the U.S.

While NUMMI will produce 200,000 competitive small vehicles in Fremont, California, we believe the U.S. market has created demand for a great many more small cars than we could supply our dealers for some time. Thus, while Saturn is under development, we plan to supplement our small car supply by importing vehicles from Daewoo Motor Company of Korea and from our Japanese affilates, Isuzu and Suzuki.

Such supply arrangements are not a new phenomenon. GM, for example, imported small trucks from Isuzu in the early and mid -'70s. But, we then proceeded to design and tool up the now popular Chevrolet S-10 and GMC S-15 compact trucks. In addition, Chrysler has imported large numbers of passenger cars and trucks from its Japanese affiliate Mitsubishi since 1978. Ford has imported cars and trucks from Mazda. Renault provides vehicles -- such as the Fuego and Le Car -- for AMC to sell in the U.S. Volkswagen of American receives the Jetta, Quantum and Dasher, among other vehicles, from its parent company in Germany.

The voluntary restraint program instituted in 1981 has not muted our efforts to increase our competitiveness. GM has maintained a costly program of investment in new products and plants. We have recently opened two all new green field plants in the U.S. and are currently readying a third for a total of over $1.5 billion. We have held price increases on our new cars to significantly less than overall inflation or than the increased costs of our inputs. Furthermore, we have held small car prices almost unchanged. Thus, at GM, the restraints have always been viewed as temporary.

The bottom line is simple. Today, no automobile company is an island. Increasingly, companies like GM will be cooperating with other companies around the world to find the best, most efficient and effective ways of building products to provide their customers with best value at lowest cost. Such managerial flexibility is crucial to the ability of U.S. producers to participate effectively in the fiercely competitive worldwide auto industry. Unless American companies are able to trade freely, invest freely and cooperate with foreign partners for mutual benefit, both the competitiveness of the U.S. production base and the competition-stimulated efficiency of the worldwide industry as a whole will suffer, as will American employment and economic well-being.

The alternatives to the successful achievement of such global competitiveness would be a choice between increasing shrinkage of U.S.-based production and employment and protectionism -- with its attendant costs and inefficiencies. A competitive U.S. auto industry, as a major participant in an increasingly efficient worldwide industry, will provide the widest choices and best values to consumers and at the same time, more secure and rewarding employment -- not only for employes of the auto industry itself, but for those in all industries dependent for their own health on ours. In so doing, the domestic auto industry can continue to enhance the competitive and strategic strength of the nation as a whole.

Senator DANFORTH. Senator Long.

Senator LONG. I just want to ask Mr. Whipple to elaborate, if you would, please, on what you said.

You said that the rest of the world already limits the imports of foreign automobiles, and that there is not really any free trade in autos anymore. Would you mind illustrating that to the extent that you are able to do that?

Mr. WHIPPLE. Sure. I think as you look around the world there are a variety of auto trade restrictions. Some are formal, and some are informal. I'll leave the border tax kinds of issues aside for a minute.

But many of the European countries, for example, have had restraint agreements with Japan for some time that are quite similar to the Japanese voluntary restraint program with the Untied States—that is, there is not legislation that says *x* amount of cars per year, but there are some clear understandings; for example in Britain, that Japanese cars won't be more than 10 to 11 percent. Italy has a very small numerical quota. France has a similar one that says, "Unless you manufacture cars here, your share may not be more than—" such and such a level.

Senator LONG. Would those be voluntary restraints?

Mr. WHIPPLE. That is exactly right. Some of the other restrictions that you see more in the underdeveloped countries; the ones that you mentioned in Latin America, for example, are more likely to be related to domestic content. In other words, the country has decided that, in order to start an auto manufacturing industry, it has to require people who want to sell in their market to manufacture in their market.

Then, there are tax considerations on top of that, and I think the Japanese auto situation is probably the best example of that. Here, autos are singled out—through a value-added or a consumption tax that does not go across the board. But a decision is made, "We want this industry to be export-oriented therefore we will apply taxes in a way that will tend to reduce demand in the home market and put pressure onto exports." So that's kind of the variety of auto trade distortions we see around the world.

Senator LONG. Would you be so kind as to submit to us something we could use for the record to expand on what you have said here, to give us more specific illustrations along that same line?

Mr. WHIPPLE. Sure, I'd be happy to, and I will put the specifics on each of those examples.

Senator LONG. Because you made the statement that there is not really any free trade in automobiles, and I suspect you might be right. But if that is the case, I just think to the extent that you can document it, you ought to be asked to document it. So that is what I am asking you to do.

Mr. WHIPPLE. I would be happy to.

Senator LONG. Thank you.

[The information follows:]

RESPONSE TO SENATOR LONG'S QUESTION
ON WORLDWIDE AUTO IMPORT RESTRAINTS

To be inserted on page 58 of the transcript of the Senate Finance Committee on International Trade, June 27, 1984 (Senator Long's Question).

The importance of automotive trade to the balance of payments for any country, and to domestic employment in countries with automotive manufacture, has led to widespread restrictions in worldwide automotive trade. In fact, roughly 90% of the car sales outside Japan and the U.S. are in countries with restrictions on auto trade, particularly on exports from Japan. These restrictions include voluntary export restraint agreements, specific import quantities (e.g., by licenses), orderly market arrangements, and performance requirements such as local content and export generation.

In general, voluntary agreements have been used most frequently by the major industrialized countries with mature car markets, e.g., the U.S., Canada, and the European-community countries. Newly industrialized countries with developing markets, such as Brazil, Argentina, Mexico, and Venezuela, frequently have used local content and/or export requirements to protect domestic production and to gain economies of scale. Lesser developed countries, faced with overall problems in generating hard currency, tend to resort to absolute quotas, high auto import tariffs, or import licenses on vehicles. The table below (attached) provides some detailed examples of automotive trade restrictions worldwide and the relative size of the car industries and Japanese sales for the various markets.

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1983 FREE WORLD AND JAPANESE CAR SALES*

	Car Industry (000)	Japanese Fully Assembled Car Imports Sales (000)	Share (Pct.)	Memo: Limits Affecting Japanese Car Imports
Major Restricted Markets				
Canada	842	167	19.9%	166,000
West Germany	2,349	224	9.5	10%-12% share
United Kingdom	1,788	189	10.5	10%-11% share
France	2,013	55	2.7	3% share
Italy	1,570	1	0.1	2,200 light vehicles
Spain	522	0	0.1	Local content; quota
Brazil	604	0	0	Local content
Mexico	192	0	0	" "
Argentina	123	1	1.0	" "
Venezuela	77	0	0	" "
Australia	411	136	33.0	" "
South Africa	273	16	5.7	" "
Taiwan	107	55	51.2	Local content
Malaysia	101	85	84.1	Local assembly; license
Nigeria	89	20	22.0	Local content
South Korea	78	7	8.4	" "
Portugal	73	0	0	" "
New Zealand	74	47	63.8	5% BU share; local assembly
Iran	51	0	0	Local content
Yugoslavia	47	Neg.	0.9	" "
India	45	Neg.	1.1	" "
Turkey	32	0	0	" "
Indonesia	29	0	0	" "
Philippines	28	0	0	Local assembly; govnm't. limits
Egypt	27	7	24.9	Local content
Colombia	27	2	7.9	" "
Morocco	15	Neg.	0.1	" "
Other Restricted**	102	53	0-90%	Varying restrictions
Total Restricted	11,689	1,065	9.1%	
Major "Monitored" Markets				
Netherlands	454	105	23.1	
Belgium/Luxemburg	362	79	21.9	
Denmark	116	36	31.1	
Ireland	61	18	30.0	
Greece	85	27	31.5	
Sweden	216	33	15.3	
Total Monitored	1,294	298	23.1	
Fully Open Markets	1,489	859	57.7	
Total Free World Less U.S. and Japan	14,473	2,222	15.4%	
U.S.	9,147	1,947	21.3	
Japan	3,315	3,280	98.9	
Total Free World	26,935	7,449	27.7%	
Restricted/Monitored as % Total Less U.S. and Japan	90%			

*Sales for 1983 estimated for selected markets on basis of latest data available.
**Includes markets with kit asssembly of vehicles with Japanese content greater than 60%.

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Senator DANFORTH. Senator Long.

Senator LONG. I must say, if anyone else shares that point of view, I would like to have the same thing.

Mr. Miller, if you agree with that, I would like to have it the same way.

Mr. MILLER. Yes.

Senator LONG. I would just like to have from these three witnesses the extent to which they agree with that statement, and whatever details you feel like submitting to support that statement, or to oppose it—either way.

Senator DANFORTH. I think Dr. Whitman has pretty well addressed this, but is the domestic manufacture of small cars a thing of the past in the United States?

Dr. WHITMAN. We are betting an awful lot of money, resources, time and energy that it is not. We don't believe small car manufacture in the United States is a thing of the past. Probably the single most important project we have currently is our Saturn project, which is designed specifically to give the lie to the statement that domestic small car manufacture is a thing of the past.

Senator DANFORTH. Mr. Whipple.

Mr. WHIPPLE. I don't think it is, either; but I think you have to look at the two things that come behind that.

I think you could say, on the other hand, if we don't do our job, if we in business don't do the things like making the Saturn project successful, then there is a real question about that.

I can say, categorically, if we don't fix the other problem that Senator Long talked about earlier—the tax situation and the exchange rate consideration—small car manufacture in this country probably will become a thing of the past. So it hinges on our performance.

Senator DANFORTH. Mr. Miller.

Mr. MILLER. Well, this fall Chrysler will face the major cutoff decision on a $600 million investment in a new small car that we have called the P car. We have already decided to move that car somewhat upscale because of the heat of competition down below and the inability to compete, and we are anxiously awaiting to see what may come out of discussions such as these.

I would observe, in the case of General Motors, that while they are talking about a no-year car somewhere out in the future that maybe will help, what they are actually doing is investing in Isuzu of Japan, investing in Suzuki of Japan, they have recently announced in the last few weeks a quarter billion dollar investment in De Wu of Korea, and they are cooperating with Toyota of course in an attempt to build small cars in Fremont. So, while they are talking about the possibility in the future of being competitive in small cars, what they actually are doing is moving very large numbers of small car jobs overseas through these various agreements.

Senator DANFORTH. Thank you very much.

The next panel is John Hemphill, vice president, market analysis, J.D. Power & Associates; Michael S. Flynn, codirector, changing manufacturer/supplier relationships, Industrial Technology Institute, and associate research scientist, center for Japanese studies, University of Michigan; and Robert W. Crandall, senior fellow, Brookings Institution.

Mr. Hemphill, my understanding is that you have come all the way from California, and you have done so at your expense. I am especially appreciative of your being here today.

STATEMENT OF JOHN HEMPHILL, VICE PRESIDENT, MARKET ANALYSIS, J.D. POWER & ASSOCIATES, WESTLAKE VILLAGE, CA

Mr. HEMPHILL. Thank you very much, Mr. Chairman.

I am vice president of J.D. Power & Associates. Our company is located in California. Our company specializes in automotive consumer research; that is our only business. We have specialized in that direction for 17 years now. We conduct more syndicated or independent studies about the U.S. automotive market than any other company in the country. By independent I mean that we fund, execute, and then attempt to market those studies to whomever is interested. So we think that we have perhaps a different perspective and a unique perspective to provide the committee on what the consumer is thinking and doing about their personal transportation needs, and also as it affects the competitiveness of the U.S. auto industry.

I have shortened my remarks a great deal. There were three areas that I wanted to cover and did cover in the written testimony; first, the image of the manufacturers—domestic, Japanese, and European—and I'll talk some about that. Second would be customer satisfaction—who is doing a better job than others, and why. And the third area that I will not cover in the oral testimony but which is covered in the written is various attitudes consumers express about industry protection.

Let me turn to manufacturer image. The image of American-built automobiles has declined, according to the findings of surveys we have designed to measure U.S. attitudes of the U.S. driving-age population. At the same time the image of imports has improved in nearly every category. Let me explain.

In mid-1979, on the heels of the Iranian crisis, J.D. Power & Associates asked a representative sample of the public to evaluate American, European, and Japanese automobiles. We asked the same question later in mid-1983, when it was evident that the industry sales recovery was underway. A summary of the results show that in six of eight categories measured during this time period the domestics increased in two—fuel economy and advanced engineering—but declined in the key areas of dependability, value for the money, and quality of workmanship.

During the same time, the Japanese nameplates increased in six of eight categories, and increased in the same six that the domestics declined in. And their greatest improvements happened to be in the categories or attributes that consumers want most in a new vehicle purchased, namely dependability and quality of workmanship.

The Europeans advanced in five of eight, but their gains were smaller than the Japanese, across the board.

The implications of the study—and there is much more data supplied with the written testimony, is that public opinion is very difficult to change, and a negative image takes years to turn around. With less than 10 percent of the U.S. personal use fleet of vehicles

being replaced each year and about one-fourth of them imports, it will take a considerable amount of time for the truly improved new domestic vehicles to change public opinion. Another implication is that the Japanese are constantly working to improve all dimensions of product quality, and the gains achieved over the domestics during this 4-year time period demonstrate that they are a moving target for the domestic industry.

Limitations on the number of Japanese cars that can enter the United States we think has had an unknown effect on image perceptions. If they have influenced public perceptions, domestic cars have not been the beneficiary. It may well be that the restraint agreement accentuated any mystique these imports possessed, and the restricted supply provided an unintended competitive advantage for the Japanese. After all, the Japanese were actually increasing their market penetration under the voluntary restraints and during most of the historic sales downturn. Also, imposing restraints in the first place was a clear signal to consumers, or an admission at least, that the domestics needed time to catch up with the Japanese.

Public image, which is what we have just discussed, is important and certainly shapes buyer preferences; but a more accurate gauge of future competitive or market position comes from measuring customer satisfaction levels of new car owners—how satisfied are people that buy the cars?

J.D. Power & Associates conducts an annual study of new car buyers by specific nameplates to determine their level of satisfaction with their cars after the first year of ownership. This results in a comprehensive consumer report on every conceivable aspect of ownership experience, including the evaluation of delivery condition, the type and frequency of repair problems, the treatment received at the dealership, and the effects of their experiences on whether they would buy the same names or models again. Our index surveys 1,000 owners for each of the 25 nameplates 12 to 14 months after the purchase. A summary of the results shows that the domestics are closing the gap in the area of delivery problems, but still about 40 percent more domestic buyers experience problems on delivery than Japanese buyers do.

In mechanical problems, generally the same is true here, with about 40 percent more domestic buyers experiencing mechanical problems during their first year of ownership, and the Europeans are, across the board, no better than the domestics.

In recurring repair problems, which are particularly important in determining repurchase intentions, it's the same story—domestics are improving, but the Japanese are too, with half of their number of owners making return visits to their dealers for recurring repairs than domestics.

The repurchase intentions? All of the above that I have discussed results in about a 10-percentage-point spread between domestics, Japanese—with Japanese leading: 80 percent intending to rebuy the same make, versus about 70 percent for domestics.

We prepare an overall composite of ratings and an index score for each nameplate, and then we rank those from top to bottom. We find that the Japanese and the European nameplates dominate the above-average rankings with six each, with only Ford and Lin-

coln-Mercury exceeding the industry average. And it might be noted that Ford and Lincoln-Mercury made significant gains over the year-prior results.

We anticipate, given the trend that we have of information on this, that the other domestics will improve as well; but the question is whether the imports, and particularly the Japanese, will further improve their standings.

I am going to skip over part of the discussion for the sake of time, Mr. Chairman, and talk about some of the conclusions we draw from this.

The domestic auto industry has not gained significantly on import competition during the past 4 years. In image, the domestic companies have actually lost ground, while in customer satisfaction only a few domestic nameplates made significant improvements.

Consumers in the United States would prefer to drive and own American-built cars. When we surveyed this, some 85 percent of the driving-age sample in January of this year agreed with the statement: "Other things being equal, I would prefer to own an American car." Not surprisingly, 91 percent of those currently driving domestic vehicles agreed with the statement; a majority, but a much lower percentage—57 percent—whose principal vehicles are imports agreed.

While this buy-America show of patriotism is encouraging for domestic manufacturers, the problem is that the public does not believe that all things are equal. In addition to the quality gap issue, there are other marketplace dynamics that bear scrutiny in assessing competitiveness and the impact of voluntary restraints.

First, the demographics of the new vehicle market suggests that the current sales boom has been stimulated and sustained by relatively affluent buyers. The transaction price is running around $11,000 on the average; the households who have decided they can make a purchase have a household income of around $36,000. The median income of those intending to buy a new vehicle in the next 12 months has risen 20 percent in just 2 years as new car prices continue to increase and eliminate more and more households from the market.

It should come as no surprise that Japanese imports sell all they can bring into the country, with their lower average prices—by around $1,000—and better perceived value.

We think that high and increasing vehicle prices threaten the recovery. We have never seen price sensitivity in the marketplace so high. Voluntary restraints prevent price competition, but, moreover, the expanded availability of high-value, lower priced cars. We estimate that total new car sales could be 10 to 20 percent higher during the next 12 months without import limitations.

Also, buyer loyalty is deteriorating. Import competition, the oil shocks, high vehicle prices, a volatile economy, and new bodystyles and technology have conspired to reduce buyer loyalty to the same make or nameplate. This applies equally to domestics and Japanese nameplates. Import restraints have little to do with this market phenomenon except to raise prices still more, continue to limit choices, and frustrate would-be buyers from exercising their shopping preferences.

Domestic car buyers are, on the average, 10 years older than Japanese import buyers; but both groups have roughly the same income. Japanese buyers, who are a median of about 37 years old, are concentrated in the so-called baby boom segment. This is the group domestic carmakers must increasingly appeal to in the years ahead. The voluntary restraints are not helping this to happen. Baby boom consumers who cannot afford today's vehicles are increasingly turning to the used-car market. After all, those that have been out of the market for 4 or 5 years and are coming back, are experiencing vehicle prices in transaction terms about 60 percent higher—about 20 percent in real terms. Many people are forced to turn to the used-car market.

More than half of the Japanese imports are still being purchased for less than $10,000; but, as with domestic models, the escalation of retail prices is pushing the market up scale.

Prospective new car buyers who go shopping for an inexpensive Japanese import are suprised to find few, if any, models that fit into their budgets. This is almost entirely due to the voluntary restraints. New low-priced models like the imported Chevrolet Sprint are finding an eager market, but 17,000 units will not even come close to meeting demand.

The industry is in danger of running out of financially qualified buyers, which could bring the sales momentum of recent months to a grinding halt. Particularly in light of the shortage of late-model used cars due to the depressed auto sales during the past couple of years and limited production of the past few years, the pent-up demand for new vehicles in the middle and lower income market is still waiting to be unleashed. As total industry sales plateau and decrease, this will ignite even more pressure for domestic industry protection, and the consumer will continue to be the victim.

One wonders who is lobbying for an end to domestic industry protection? The Japanese distributors and dealers are earning extremely healthy profits on the limited supply of upscale option-loaded automobiles; there is no unity among domestic companies on this issue. GM wants to bring in more imported cars, but for now is earning record profits on its larger, more expensive models; Ford and Chrysler have not yet been able to line up joint venture partners that would allow them to compete with the Japanese, and they are now leading the effort to continue protectionist measures. The UAW sees nothing but dark clouds in their future and has nothing to lose by supporting protection.

The competitive position, to summarize, of the U.S. automakers has improved in sales and profits, but trade restrictions have not caused this to happen. The traditional cyclical recovery has converted pent-up demand in high-income households to market sales. Voluntary restrictions lengthened and deepended the recession by restricting supply and postponing low-priced, high-valued product introductions. These same supply limitations now threaten to choke off further sales growth. In both recession and recovery, the consumer is bearing the burden of restrictions.

Thank you.

Senator DANFORTH. Thank you, sir.

[Mr. Hemphill's prepared statement follows:]

THE CONSUMER VIEWPOINT ON COMPETITIVENESS OF THE U.S AUTOMOBILE INDUSTRY

Submitted For Testimony To The

Hearing On The State Of The
U.S. Automobile Industry

United States Senate
Finance Committee And
Subcommittee On International Trade

June 27, 1984

Prepared By

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INTRODUCTION

Mr. Chairman and Members of the Committee:

My name is John M. Hemphill, Jr. I am Vice President of Market Analysis for J. D. Power & Associates. Trained as an economist, my expertise is in measuring and interpreting consumer behavior. The company in which I am an officer specializes, more than any other organization in this country, in independent automotive consumer research.

J. D. Power & Associates was founded 17 years ago with the specific mission of monitoring and analyzing what U.S. consumers are thinking and doing about their personal transportation needs. The major thrust of our business is conducting automotive consumer studies that we fund, design, and execute ourselves, and then market to interested individuals or organizations. Clients for our independent studies include virtually all domestic, Japanese, and European car manufacturers, original equipment and aftermarket suppliers, and U.S. governmental agencies.

We believe our independent status and research specialization provides a unique and objective perspective for this Committee in assessing the effects of the Voluntary Restraint Agreement and the competitiveness of the auto industry.

My objective in this testimony is to present the consumer's viewpoint about competitiveness in the U.S. auto industry, as follows:

1. Manufacturer Image: How have driving-age consumers changed their perceptions of domestic, European, and Japanese automakers during the past four years?
2. Customer Satisfaction: Which manufacturers are doing the best job of satisfying their customers, and why?
3. Industry Protection: How do consumers view various measures intended to protect domestic automobile manufacturers?

MANUFACTURER IMAGE

The image of American-built automobiles has declined--according to the findings of surveys designed to measure attitudes of the U.S. driving-age population--while the image of imports have improved in nearly every category. In mid-1979, on the heels of the Iranian crisis, J. D. Power & Associates asked a representative sample of the driving-age public to evaluate American, Japanese and European-built automobiles. We asked the same question four years later, in 1983, when it was evident that the industry sales recovery was underway. The results are shown in Table I on the following page:

TABLE I

Changes In Ratings Of Car Manufacturers By Country Of Origin, 1979-1983
(Mean Ratings On A Five-Point Scale, with 5=Excellent, 1=Poor)

	American Built			Japanese Built			European Built		
	ACP			ACP			ACP		
	1979	1983	Absolute Change	1979	1983	Absolute Change	1979	1983	Absolute Change
Value For Money	3.03	2.90	-0.13	3.14	3.24	+.10	3.11	3.09	+.02
Dependability/ Minimal Repairs	3.04	2.86	-.18	2.80	3.06	+.26	2.85	2.93	+.08
Ability To Design Sub-Compact Cars	2.74	2.68	-.06	3.77	3.76	-.01	3.61	3.38	-.23
Passenger Comfort	3.80	3.67	-.13	2.72	2.70	-.02	3.04	3.10	+.06
Fuel Economy	2.47	2.73	+.26	3.77	3.86	+.09	3.50	3.40	-.10
Advanced Ideas For Engineering	3.09	3.13	+.04	3.36	3.54	+.18	3.46	3.47	-.03
Overall Quality Of Workmanship	2.80	2.76	-.04	3.10	3.39	+.29	3.37	3.46	+.09
Availability Of Parts & Service	3.95	3.88	-.07	2.46	2.66	+.21	2.29	2.42	+.13
Styling Or Appearance	NA	3.59	--	NA	3.09	--	NA	3.36	--
Products Priced As Low As Possible	NA	2.35	--	NA	2.49	--	NA	2.13	--
Eight Category Average*	3.10	3.08	-.04	3.14	3.28	+.14	3.15	3.16	+.01

* Excludes Styling Or Appearance And Products Priced As Low As Possible

Sample Size: 1979 = 5082 1983 = 5045

Source: J. D. Power & Associates
Automotive Consumer Profile

The eight-category average ratings declined for American-built cars, in the four year period, and improved for both Japanese and European-built cars. Domestic cars did improve significantly in fuel economy and in their image for possessing advanced ideas in engineering. But in other important categories of image such as dependability and value for the money, ratings of American-built cars declined compared with the earlier study in 1979.

Japanese cars were evaluated more positively than they were four years ago in six out of eight categories. Moreover, in four of these same six categories, Japanese cars were rated more highly than domestic cars both in 1979 and 1983, so it has been a case of good ratings getting better. Japanese cars were given the highest ratings, and showed greatest improvement, in two very important categories: "value for the money" and "dependability/ minimal repairs." Domestic cars were rated most negatively on these attributes, and showed declines from the 1979 survey.

The negative perceptions of domestic car dependability is particularly serious for U.S. automakers, since this is the most desired attribute in new-vehicle purchases. Japanese cars also gained, and domestics lost ground, in image for "overall quality of workmanship."

The domestic manufacturers have been emphasing product quality as never before, and introducing, at considerable cost, new technologies and new models. However, public opinion is difficult to change and a negative image takes years to turn around. With less than 10% of the U.S. personal-use fleet of vehicles being replaced each year, and one-fourth of them imports, it will take a considerable amount of time for the truly improved new domestic automobiles to change public opinion. Another implication is that the Japanese are constantly working to improve in all dimensions of product quality, and the gains achieved over the domestics during this four-year period demonstrate that Japanese automakers are a moving target for the domestic industry.

Limitations on the number of Japanese cars that can enter the U.S. has had an unknown effect on image perceptions. If they have influenced public perceptions, domestic cars have not been the beneficiary. It may well be that the restraint agreement accentuated any mystique these imports possessed and the restricted supply provided an unintended competitive image advantage for Japanese autos. After all, the Japanese were actually increasing their market penetration under the voluntary restraints during most of the historic sales downturn during this four year period. Also, imposing restraints in the first place was a clear signal or admission to the consumer that the domestics had to "catch up" to the Japanese.

CUSTOMER SATISFACTION

Public image is important and certainly helps shape buyer preferences, but a more accurate gauge of future competitive or market position comes from measuring customer satisfaction levels of new-car owners. It is the total ownership experience that determines whether a particular customer will purchase the same make again or recommend the vehicle to someone else. This kind of word-of-mouth endorsement is a major factor in the image of auto manufacturers.

J. D. Power & Associates conducts an annual study of new-car buyers by specific nameplates to determine their level of satisfaction with their cars after the first year of ownership. This results in a comprehensive customer report on every conceivable aspect of the ownership experience, including their evaluations of the delivery condition of their vehicles, the type and frequency of repair problems they have had, the treatment received at the dealership, and the effects of their experiences on whether they would buy the same makes/models again. Our Customer Satisfaction Index Study samples 1,000 owners for each of nearly 25 nameplates, 12-14 months after they made their purchase. Some examples of how domestic, Japanese, and European nameplates fared are reviewed here.

Domestic nameplates have a higher incidence of problems on delivery than the Japanese, but the gap appears to be closing somewhat.

Incidence Of Problems On Delivery

	Model Year		
	1981	1982	% Point Difference
Owners of:			
Domestic	52%	50%	-2
Japanese	34	36	+2
European	49	47	-1

Domestic nameplates have twice the frequency of the Japanese in problems with fit/finish of body parts (21% vs. 10%), and cars that have problems with electrical systems (10% vs. 5%).

There also continues to be a gap between domestics and Japanese on incidence of mechanical problems, but both increased in frequency between 1981 and 1982 model years.

Incidence Of Mechanical Problems

	Model Year		
	1981	1982	% Point Difference
Owners Of:			
Domestic	54%	56%	+2
Japanese	35	39	+4
European	46	59	+13

Minor engine problems lead the list, with 25% of domestic owners but only 10% of Japanese owners reporting such problems.

We find that customers particularly dislike problems that are not fixed on the first visit to the dealer. Again, the Japanese lead domestics by a wide margin, with both improving from the 1981 to 1982 model years.

Owners Experiencing Recurring Repair Problems

	Model Year		
	1981	1982	% Point Difference
Owners of:			
Domestic	40%	34%	-6
Japanese	23	19	-3
European	35	31	-4

Problems owners have on delivery, mechanical malfunctions, and problems not fixed on the first visit back to the dealer all affect the predisposition of the customer to purchase the same make of car again.

Positive Repurchase Intentions

	Model Year		
	1981	1982	% Point Difference
Owners Of:			
Domestic	67%	67%	-
Japanese	76	78	+2
European	71	76	+5

To provide a composite rating, we develop a customer satisfaction index based on all ratings a nameplate receives.

Customer Satisfaction Index

Industry Average = 100	Model Year 1981	1982
Mercedes-Benz	155	159
Toyota	149	137
Subaru	117	135
Honda	148	124
Mazda	107	118
Volvo	115	115
Lincoln/Mercury	92	114
BMW	126	110
Saab	NA	108
Porsche/Audi	97	108
Ford	89	107
Mitsubishi*	94	103
Jaguar	NA	101
Nissan	106	101
Volkswagen	102	98
Dodge	NA	93
Oldsmobile	92	92
Chrysler/Plymouth	NA	90
Chevrolet	89	83
Isuzu	112	81
Cadillac	92	81
Buick	87	80
Pontiac	72	77
AMC	81	76
Renault	59	60

* Captive Imports Sold Through Chrysler
NA = Not Available

Source: J. D. Power & Associates

Here we see that the Japanese and European nameplates dominate the above-average scores with six each. Only Ford and Lincoln/Mercury exceed the industry average for domestic nameplates, each registering impressive gains over their prior year rankings.

The key to success for the above-average nameplates is product quality, in terms of how few product or mechanical problems the buyers experience. The top Japanese and European car companies have made great strides in improving their dealer service and parts networks. But good service and customer satisfaction essentially result from product quality built into the car during production. Significant gains by Ford and Lincoln/Mercury demonstrate improvements in product quality, and we anticipate that other domestic nameplates will increase their ratings on customer satisfaction in our study of 1983 model year automobiles. The key question is whether the import nameplates can improve still further and maintain their lead in customer satisfaction.

INDUSTRY PROTECTION

Consumers cannot be expected to understand all of the complex issues involved in maintaining competitiveness in the automobile industry. Their reactions to various legislated measures aimed at helping domestic manufacturers become more competitive depend a great deal on prevailing economic conditions, and on how questions about the issue are asked.

A survey on domestic industry protection we conducted in the Spring last year came at the tail end of the worst auto recession in decades. The plight of the U.S. auto industry had been featured nearly daily in the popular press and electronic media. Employment losses, sales problems, high interest rates, technology and quality gaps had riveted consumer attention on the U.S. auto industry. As the longest recession in the auto industry ended last year, consumers were confused about what, if anything, the government should do about protecting the domestic industry.

In the survey, after describing the voluntary limits on Japanese cars, the consumer was told that even under these restraints, the Japanese had actually increased their share of the U.S. new car market. In addition, the respondents were told that U.S. jobs would be retained by protecting the industry even though the price of new Japanese autos would likely increase. Then, consumers were asked to indicate on a forced-choice basis what they felt should be done about the situation.

Domestic Auto Industry Protection

	Total Sample (N= 2,105)
Support Voluntary Japanese Limitation	28%
Enact "Local Content" Legislation/Drop Voluntary Limits	25
Drop All Measures Protecting Domestic Auto Industry	22
No Opinion	24
No Answer	1
	100%

Close to an equal number of people chose each of the three options listed, with a significant proportion having no opinion. Geographically, consumers in the Northeast were about equally divided between having voluntary restraints vs. local content (30% each). In California, about 30% each favored voluntary restraints or dropping all measures protecting the domestic industry; only 14% favored local content requirements.

Just over a year before, in 1982, the driving public was decidely against protecting the domestic industry, but the questionnaire did not couch protection as necessary to prevent loss of U.S. jobs. Nearly half of the public (47%) said the market should be open and freely competitive, or that U.S. auto makers needed to produce more competitive cars on their own. Only one in three favored restrictions of any kind on the number of Japanese vehicles imported to the U.S.

As always, on such complex or emotional issues, responses certainly depend on both the prevailing economic conditions and on how the questions are presented. A slightly favorable reaction to protection measures is to be expected if economic conditions are perverse, and especially if respondents are told that jobs are at stake unless foreign competition is curtailed.

CONCLUSIONS

The domestic autc industry has not gained significantly on import competition during the past few years. In image, the domestic companies have actually lost ground, while in customer satisfaction only a few nameplates have made significant improvements.

Consumers in the U.S. would prefer to own and drive an American car. Some 85% of a driving-age sample in January 1984 agreed with the statement: "Other things equal, I would prefer to own an American car." Not suprisingly, 91% of those currently driving domestic vehicles agreed with the statement. A majority, but a much lower percentage, 57%, whose principal vehicles are imports agreed. While this "Buy American" show of patriotism is encouraging for domestic manufacturers, the problem is that the public does not believe all things are equal.

The American public can be counted on to respond in a patriotic way to questions about supporting U.S. jobs and the economy. With this in mind, that only 57% of import owners agreed with the statement might be a real disappointment. Some import owners likely are defending their purchases, but it is also likely that a substantial number are not very convinced all things could be or will be equal.

In addition to the quality gap issue, there are other marketplace dynamics that bear scrutiny in assessing competitiveness and the impact of voluntary restraints. First, the demographics of the new vehicle market suggest that the current sales boom has been stimulated and sustained by relatively affluent buyers. With transaction prices around $11,000, the households who have decided they can make a purchase have a median income of close to $36,000. The median income of those intending to buy a new vehicle has risen about 20% during the past two years, as new car prices continue to increase and eliminate more and more households from the market. It should be no surprise that Japanese imports sell all they can bring into the country, with their lower average prices (by about $1,000) and better perceived value.

But high and increasing vehicle prices threaten the recovery. Voluntary restraints prevent price competition and the expanded availability of high-value lower-priced cars. We estimate that total new car sales would be 10-20% higher during the next 12 months without import limitations.

Also, buyer loyalty is deteriorating. Import competition, the oil shocks, high vehicle prices, a volatile economy, and new bodystyles and technology have conspired to reduce buyer loyalty to the same make or nameplate. This applies equally to domestic and import nameplates. Import restraints have little to do with this market phenomenon, except to raise prices still more, continue to limit choices, and frustrate would-be buyers from exercising their shopping preferences.

Domestic car buyers are, on the average, 10 years older than Japanese import buyers, but both groups have roughly the same income. Japanese buyers who are a median of about 37 years old are concentrated in the so-called baby-boom age segment. This is the group domestic car makers must increasingly appeal to in the years ahead. But voluntary restraints are not helping this to happen. Baby-boom consumers who cannot afford today's vehicles are increasingly turning to the used car market. More than half of the Japanese imports are still being purchased for less than $10,000 but, as with the domestic models, the escalation of retail prices is pushing the market upscale. Prospective new-car buyers who go shopping for an inexpensive Japanese import are surprised to find few, if any, models that fit into their budgets. This is almost entirely due to voluntary restraints. New low-priced models like the imported Chevrolet Sprint are finding an eager market, but 17,000 units will not even come close to meeting demand.

The industry is in danger of running out of financially qualified buyers, which could bring the sales momentum of recent months to a grinding halt. Particularly in light of the shortage of good, late model used cars (due to depressed auto sales and limited production of the past few years), the pent-up demand for new vehicles in the middle-and lower-income market is still waiting to be unleashed. As total industry sales plateau and decrease, this will ignite even more pressure for domestic industry protection, and the consumer will continue to be the victim.

One wonders who is lobbying for an end to domestic industry protection. The Japanese distributors and dealers are earning extremely healthy profits on the limited supply of upscale, option-loaded automobiles. There is no unity among domestic companies on this issue: GM wants to bring in more imported cars, but for now is earning record profits on its larger, more expensive models. Ford and Chrysler have not yet been able to line up joint-venture partners that would allow them to compete with the Japanese and are leading the effort to continue protectionist measurers. The UAW sees nothing but dark clouds in their future, and has nothing to lose by supporting protection. They support local content legislation most strongly, of course, because supply limitations have stimulated Japanese, non-union manufacturing/assembly to locate here, and does not prevent off-shore sourcing of components and products.

The competitive position of the U.S. automakers has improved in sales and profits, but trade restrictions have not caused this to happen. A traditionally cyclical recovery has converted pent-up demand in high income households to market sales. Voluntary restrictions lengthened and deepened the recession by restricting supply, raising prices, and postponing new product introductions. These same supply limitations now threaten to choke off further sales growth. In both recession and recovery the consumer is bearing the burden of restrictions.

STATEMENT OF MICHAEL S. FLYNN, CODIRECTOR, CHANGING MANUFACTURER/SUPPLIER RELATIONSHIPS, INDUSTRIAL TECHNOLOGY INSTITUTE, AND ASSOCIATE RESEARCH SCIENTIST, CENTER FOR JAPANESE STUDIES, UNIVERSITY OF MICHIGAN, ANN ARBOR, MI

Mr. FLYNN. Thank you, Mr. Chairman.

I am going to abbreviate my remarks and try to cover a couple of points I think have been touched on lightly.

Senator DANFORTH. Your full testimony and the testimony of all of the witnesses will automatically be included in the record in full.

Mr. FLYNN. Let me begin by stressing that the U.S. automotive industry that we are talking about here today is a highly diverse and diffuse collection of manufacturing companies: the assemblers—from whom we have already heard—their many divisions, and a wide variety of processers and producers of raw materials, parts and components, which ultimately wind up in an automobile.

As much as 55 percent of the purchased value of the U.S. automobile is provided by suppliers whose home industries range from steel and rubber to plastics and electronics. These upstream suppliers number as many as 40,000 firms, and as recently as 1979 were estimated to provide employment for 1.4 million people. After VRA, by 1983, at least a third of these jobs are estimated to have disappeared.

By the way, historically the supplier industry has provided approximately 40 to 50 percent more jobs than have the major assemblers themselves.

It is very important in discussing an issue such as VRA that we keep in mind that the auto industry is a very complex, diverse collection of firms who engage in many different basic kinds of businesses, who have different degrees of dependence upon the industry, and who are of very different sizes. Too often we tend to view the assemblers, or more especially the Big Three, as constituting and representing the automotive industry. I think this is not the case, and it is an error to assume that it is.

In terms of competition in the industry—since I was specifically asked to address the competitive status of the U.S. automotive industry—I think we have already heard from some prior witnesses that the definition of competition in the automobile industry is no longer solely one of direct head-to-head competition in the marketplace. Companies are exploring joint ventures, they are taking equity positions, they are arranging purchases from erstwhile competitors. Clearly the name of the game has changed.

I would again call attention to the complex structure of the industry, which suggests that the kinds of competitive options available to actors in the industry differ, depending upon whether they are assemblers or whether they are, in turn, parts suppliers. Parts suppliers do not have the ready option that the assemblers do to become marketing companies who will simply purchase their product and pass it on.

Let me very quickly specifically comment on a number that we heard, I think, twice this morning and usually hear more often, the world-famous "manufacturing cost difference," the asserted differ-

ential for a U.S. producer and a Japanese producer to manufacture the same small car.

I think it is fair to say that that number has come to symbolize for the industry and much of the public the competitive disadvantage of the U.S. industry vis-a-vis the Japanese. I think that is terribly unfortunate, for two reasons: First of all, I don't believe the number is real. It is a number that is so hedged in by assumptions made by analysts, and by the specific real circumstances facing the company or producer at a particular time, that it is not a number that has any enduring specific meaning.

I think at the same time it is a number that oversimplifies a terribly complex problem, a problem that does have multiple sources. We have heard a lot today about the yen-dollar exchange rates; we have heard a lot about tax rates. I would add two other sources that these reports actually all consider. They are wage rates and productivity differences. But since my time is short, let me very quickly say that the variation of the analyses of manufacturing cost difference on the importance of wage rates and productivity is enormous.

Let me start with productivity. Productivity in the Japanese industry is estimated to be anywhere from 20 percent to 240 percent higher than the U.S. industry. That differential itself is estimated to account for about 10 percent to over 50 percent of the total manufacturing cost difference.

Wages in the Japanese industry are portrayed as constituting from about 40 to 60 percent those of the U.S. industry. That factor is estimated to account for anywhere from about 25 to 80 percent of the total cost difference. There is tremendous variation in those numbers.

In terms of my own analysis of these papers, I am less persuaded than most analysts are that wage factors are in the long run critical, because I think there are some self-correcting aspects to them. I think we have seen restraint in wage demands. The Japanese industry, for a variety of structural reasons, is going to be facing escalating wage costs over the next 10 years.

We will always have a disadvantage in labor rates compared to somebody—if it's not Japan, it will be Korea next. I think we have to learn to live with that through more efficient production.

I am more concerned about the productivity differences, and one of my major concerns here is that we are competing with a Japanese production machine which has evolved over 30 years. It is highly efficient, technically sophisticated, and imbedded in a very supportive social system within the factory. It is going to take us time to learn to replicate that. We can learn about just-in-time, we can learn about how to lay out a plant floor, and we can learn about how to save space; but to pull all of those factors together, and to alter the relationship between the OEM's and the supplier community in a way that allows us to compete head to head, will require substantial time.

Right now, I think that if the U.S. industry were required to compete with an unimpeded flow of Japanese vehicles, we would be in serious trouble indeed. We would lose lots of jobs and lots of firms. My major reason for feeling that is that the internal dynamics of competition in the Japanese market, and the closing out of

some of the smaller Japanese manufacturers from the U.S. market due to VRA would put incredible pressure on Japanese manufacturers to indeed let their market share grow, whether MITI liked it or not. Whether it would be 40 percent or not, I don't know; but I can certainly envision pressures that would lead that to happen.

Senator DANFORTH. That would lead what to happen, sir?

Mr. FLYNN. The Japanese producers, because of the internal dynamics of competition, flooding the U.S. market, beginning to take advantage of their cost advantage, moving further upscale in the vehicles they import, and capturing a substantially increased market share.

Senator DANFORTH. Thank you.

[Mr. Flynn's prepared statement follows:]

Testimony before the

Subcommittee on Trade
Finance Committee
United States Senate

The Competitive Status of the U.S. Automotive Industry

Michael S. Flynn
Industrial Technogy Institute
and The University of Michigan
June 27, 1984

I have been asked to direct my remarks today to the competitive state of the U.S. automotive industry. In so doing, I will broadly draw upon the work of my colleagues on the Joint U.S.-Japan Automotive Study, although most heavily upon my own work in two areas: first, the relationships between the vehicle manufacturers and their suppliers of intermediate goods; and second, the size and sources of the manufacturing cost difference between U.S. and Japanese manufacturers. My basic intention is to provide you with information which will, I hope, assist you in giving due consideration to the multiple problems, concerns, and interests of a highly complex and differentiated industry.

NATURE OF THE INDUSTRY

Let me begin by stressing the fact that the "U.S. automotive industry" is a highly diverse and diffuse collection of manufacturing companies, spanning the automotive assemblers, their many divisions, and a wide variety of processors and producers of raw materials, parts, and components which ultimately are incorporated into motor vehicles. The automotive assemblers are themselves a diverse group, with quite different interests

with regard to trade issues, reflecting differences in their own international connections, as well as in their business strategies. As much as 55% of the purchased value of a U.S. automobile is provided by suppliers whose home industries range from steel and rubber to plastics and electronics.

These "upstream" suppliers, numbering some 40,000 firms, enjoyed some $40 billion in sales to the four domestic manufacturers in 1980, by which time the downturn in the industry was in progress. However, approximately 4800 of these firms accounted for roughly 85% of these sales, and, in fact, some 120 firms alone accounted for 45% of this total. It is important to keep in mind, moreover, that these very large suppliers to the manufacturers in terms of dollar volume, typically have a relatively low percentage of their total sales concentrated in the automotive sector. It appears, on the other hand, that the many "small" suppliers tend to have a much larger concentration of their sales in the automotive sector. These suppliers and their own automotive-related suppliers were estimated to provide 1.4 million jobs as of 1979, at least a third of which had disappeared by the time the upturn began in 1983. Historically, the supplier industry is estimated to provide approximately 40% to 50% more jobs than do the assemblers themselves.

So the automotive supplier industry is a critical component of the U.S. automotive industry; at the same time it is a highly diffuse and diverse group of firms. It includes companies which supply the manufacturers directly and those who do so through other supplier firms; there are a relatively few large suppliers who tend to be less dependant upon the assemblers, and many small suppliers who tend to be more dependant upon them; it spans companies from a wide variety

of home industries. Too often we view the assemblers or "the Big Three" as constituting the automotive industry, or at least assume that they are representative of the total industry for all practical and policy considerations. This is plainly not the case, and the identification of the problems, concerns, and interests of the manufacturers with those of the industry in toto is, in some important respects, an error.

COMPETITION IN THE INDUSTRY

We tend to think of economic competition between two industries much as we think of economic competition between two sales agents: how much is each one selling? This leads us to ask questions about sales, market share, profit levels, and other straight-forward economic measures, and at the same time, to focus on the final assemblers or manufacturers, often as though they are the only relevent firms.

We need to broaden our understanding of economic competition between industries. Especially in the case of autos, the last 15 or so years have seen significant changes in the nature of competition, as well as the specific outcomes of that competition. Each of the Big Three have equity holdings in Japanese automotive manufacturers, although not with either Toyota or Nissan, the largest Japanese assemblers. These relationships have resulted in the importation of finished vehicles and/or major components for sale or use by the U.S. manufacturer. Joint ventures have been explored, and at least one is in the process of implementation at this time. Decisions to make or to buy a particular part, component, or subassembly impact not only the level of vertical integration of the assembler, but in some cases the very existence of a supplier. When decisions to buy are made, whether that buy

will be from a domestic or a foreign supplier has profound implications for the size, structure, and shape of the domestic automotive industry. Competition allows many options besides direct challenges in the market place, and it is not surprising that some of these options have been, and in all liklihood will continue to be, central to the strategies of the U.S. assemblers. Some of these strategies, however rational for the company in question, may well permanently alter the traditional and current structure of the U.S. industry. Reliance on captive imports, the off-shore sourcing of parts and components, and the pursuit of a variety of cooperative ventures are likely to involve the loss of firms and jobs from the supplier base within North America. In particular areas, such as metal working and machine-tool making, the potential damage to our remaining industrial capacity is potentially quite large.

In thinking about the competitive condition of the U.S. industry, then, we need to be quite cautious about identifying what is "good" for the industry with what one or more assemblers, or even all of the Big Three and the very large supplier firms, identify as in their own best interests, however temporarilly. Each firm in the industry has its own particular competitive situation to address, and just as these firms are quite different, so too are their competitive situations. Yet it is the larger firms, especially the assemblers, who are most able politically to ensure that their views are considered and taken into account. We also need to recognize quite openly the huge capital investment requirements, in both product development and capital equipment areas, that the U.S. industry must make over the next five or ten years if the option of direct competition with the

Japanese industry is to become a viable one. Whether these expenditures will be made, of course, is an open question, since there are also capital requirements for pursuing other strategic options. So too it is an open question whether or not the record profit levels of the Big Three are in any sense typical of the industry. There is reason to think that the strong pressures exerted by the assemblers upon the suppliers has limited the suppliers' opportunity to benefit from the current prosperity. It may well be the case that supplier firms, especially smaller ones, have not yet begun to amass the capital which they will require for their own product and process investments.

COMPETITIVE STATE OF THE U.S. INDUSTRY

I think that it is fair to say that an elusive number -- the manufacturing cost difference -- has come to symbollize, both for the industry and the public, the competitive disadvantage of the U.S. industry viv a vis the Japanese. This is somewhat unfortunate, both because this number is in many senses not a real number, although it is treated as such, and because it reduces a very complex comparison to an oversimplified summary. The number is not real in the sense that any particular calculation of it depends upon the specific vehicle (or mix of vehicles) compared, adjustments for the level of vertical integration of the production process made by the analyst, the capacity utilization rate of the manufacturers or plant sites compared, and the level of technological content of the manufacturing process. It is not surprising that the publically available reports show a wide range of specific estimates, ones which I find less mutually supportive than do their authors or the industry in general. On the other hand, these reports do

support the arguement that in the period 1978-1981, the U.S. assemblers faced a substantially higher cost of production than did their Japanese competitors.

These reports identify a wide range of sources for this cost disadvantage, from taxes and exchange rates to wage rates and productivity. Different reports consider different factors, make different assumptions about the operation of these factors, and follow different rules in partitioning the cost difference among its many possible sources. All of these reports consider two factors: the number of hours which go into a vehicle, or "unit labor productivity", and the wage costs associated with those hours. Each report estimates that over 50% of the cost difference is accounted for by this "labor content". However, the reports widely differ in the extent to which they attribute the cost difference to each of these underlying components of labor content. Productivity in the Japanese industry is reported to be anywhere from 20% to 240% higher than in the U.S. industry, and this differential is estimated to account for from about 10% to 54% of the total cost difference. Wages in the Japanese industry are portrayed as consituting from 45% to 60% those of the U.S. industry, and this factor is estimated to account for anywhere from 25% to 80% of the total cost difference.

It is difficult to estimate exactly what these cost comparisons are today. The U.S. assemblers are functioning at much higher caspacity utilization rates, labor costs have been restrained both through renegotiations and altered work rules, specific savings have been made from inventory practises and pressure on suppliers, and break-even points substantially reduced. At the

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same time, the exchange rate for the yen has weakened, the ratio of retired to active workers has increased, and the Japanese industry has not been standing still.

In the long run, I am less concerned about wage differentials than I am about productivity differentials. I feel strongly that these reports underestimate the actual wage costs incurred by the Japanese industry, at the same time that I feel the permanent employment system, the seniority based wage system, and the aging labor force will all combine to increase these costs for Japan. A disadvantage in labor rates is something we will continually face, be it from Japan, or somewhere else, and we will simply have to compensate for that fact through efficient use of labor. We tend to blame the automotive industry for high labor rates, much of which is due to choices we make as a society and as individuals. The Japanese assemblers, for example, have substantially lower medical costs to provide an equivalent level of care because of a national health insurance plan. They are also able to secure economies of scale in providing benefits such as housing for their workers, where the U.S. assemblers compensate their employees in cash. I would also stress that our analysis of published data suggests that about one-half of the unit cost difference associated with labor rates in 1979 was due to differences in the compensation of salaried employees, and about one-half due to differences between hourly employees. This is because the differential from Japan for salaried workers is larger than for hourly workers, so that even though salaried workers are a smaller proportion of the work force, they still account for about the same level of unit cost difference as do hourly workers.

I find the productivity differentials to be more problematic for a number of reasons. First, the Japanese have evolved a highly efficient, technically sophisticated production process which is embedded in a supportive social system within the factory. Because of the long-term, close relationships between the assemblers and their supplier companies, information and assistance in these areas has spread rather rapidly throughout the industry, whether involving research and development on hard technologies, their implementation, or the development of social structures and technologies to support them. For a variety of reasons, the relationships between U.S. assemblers and their suppliers -- even their own internal supplier divisions -- have been considerably less close, and imbued with a short-term orientation. That means that there is much more time required for the identification and successful implementation of advanced manufacturing techniques and their supportive frameworks. Second, I think that the U.S. assemblers face tremendous pressure to compensate for these productivity differences by sourcing from abroad, where factor prices are lower, even though the differences in both labor rates and productivity appear to much lower at the supplier level of the industry. I am afraid that decisions to purchase abroad will permanently alter the shape of the U.S. industry, as it denies the supplier industry the time and resources it requires to improve its own competitive position. Third, I think that closing the productivity gap requires both time and resources, commodities which I'm afraid would be in scarce supply for the U.S. automotive

industry were it currently required to face direct competition from the Japanese, especially since the dynamics of competition within the Japanese automotive industry itself would likely make this competition fierce indeed.

CONCLUSION

In principle I am in favor of unrestricted trade. I recognize, however, that in automobiles there is little unrestricted trade, as various nations have erected quotas, tariffs, and domestic content requirements around autos. I do not accept the position that the Japanese automotive manufacturers are competing unfairly, either through their own actions or the actions of their government. I do recognize, however, that the U.S. automotive industry, for a variety of reasons many of which were and are outside the control of the industry or its constituent firms, has found itself facing a severe competitive disadvantage. This disadvantage is one which will take money and time to correct. While I find concern in some of the strategy options being explored by the assemblers, I am heartened by some of the changes I see in the industry. The assemblers themselves have made subtantial progress in both cost reduction and quality improvement, although, to be sure, they still have quite a way to go to catch up with the Japanese industry. Our own work with supplier firms suggests that some very basic messages have been accepted by the industry: product quality is seen as increasingly important both in cost-reduction efforts and in securing business; advanced manufacturing technologies are being actively considered for implementation; and the supplier community sees evidence of positive changes in their relationships

with the assemblers. I think cooperative efforts between the union and the assemblers, such as GM's small car project, as well as the increased recognition on the part of both management and labor that there are areas in which mutually beneficial cooperation is possible, bode well for the industry. The probable emphasis upon job security rather than economic gains by the UAW for the upcoming negotiations, despite some rather unfortunate recent decisions regarding top management bonuses, signals a longer-range view than has historically characterized the industry, whether labor or management.

It is terribly important to keep in mind that the U.S. automotive industry is an extremely large and complex structure. While it commands huge resources, it realistically takes time to martial them and to direct them towards the solution of the myriad problems which the industry has faced over the last five years. The industry has made progress, and in spite of some ill-considered decisions, seems on balance to have largely avoided the danger of slipping back into old practises with the upturn in production of the past year. It still requires time, however, and the opportunity to earn the money required for capital investment and product development programs. It would not be unwise, however, to give due consideration towards what ends that time and opportunity may be directed.

Of particular concern to me is the situation of the small supplier, whose profit margins have been trimmed to provide cost-reductions for the assemblers, and whose resources are not adequate to support the identification and implementation

of advanced manufacturing techniques, both technological and social. The assemblers have made some moves to assist these suppliers, and the creation of centers such as the State and industry supported Industrial Technology Institute in Michigan should provide assistance for this large group of firms. But here time and financing are even more critical issues, and legislation in areas other than trade may be required for effective assistance. I am thinking here particularly of legislation such as H.R. 4047, designed to foster the development and implementation of advanced manufacturing technology. Federal support for research and development in this area is critical, and that is especially true for small manufacturing firms. And it is, of course, small firms which typically provide major growth in employment opportunities.

The major points I hope I have conveyed to you can be summarized as follows. First, the U.S. automotive industry is both large and complex, and covers many firms besides the traditional automotive assemblers. Second, the nature of competition within the U.S. market has changed dramatically over the past 15 years, and the interests of any particular participant or type of participant is not necessarily identical with the interests of the industry as a whole. Third, the Japanese manufacturers do enjoy a cost advantage over their U.S. counterparts, although the U.S. industry has made impressive improvements over the last four years. Fourth, in view of the size and complexity of the industry, the past four years have not provided sufficient time for it to become directly competitive with the Japanese industry. Fifth, some attention should be paid to the actual use to which this "breathing space" has and will be put.

Senator DANFORTH. Senator Matsunaga.

Senator MATSUNAGA. Thank you, Mr. Chairman. I can wait until Mr. Crandall is finished.

Senator DANFORTH. Mr. Crandall isn't here.

Senator MATSUNAGA. A constituent of mine sent me a rather disturbing article from the Chicago Times with a note saying, "What are you going to do about this?"

I am wondering, from the marketing point of view, what we can do. Let me read you the article as this is something that I have personally taken deep interest in. As a matter of fact, I have introduced a bill for the development of hydrogen as the fuel for transportation, both air and ground.

The article reads:

> Hydrogen car engine to be sold in United States. Dateline: Tokyo, Japan, by Reuters. The world's first hydrogen engines for cars will be marketed by a Japanese company in the United States later this year, the president of the manufacturing company said. Special attachments developed by Hydro Energy Laboratory Project Inc. will enable conventional engines to use metal hydride, an alloy that stores hydrogen, as fuel, President Kenji Watanabe said.
>
> Modification of a conventional engine to use the attachments—a tank filled with metal hydrides and a water tank—will cost $1,000, Watanabe said.
>
> The modified engine runs on steam pressure created by the combustion of hydrogen gas.

Now, with the crisis in the oil industry and our strong dependence upon foreign sources for our petroleum supply, why should we not be going toward this development? Why should not the American auto industry be taking the lead in this area? Would this be something that the economy and the market could promote?

Mr. HEMPHILL. Well, just a brief comment. I think all of the domestic companies are diligently working on alternate fuels. I think some of the pressure and some of the incentive for doing that has been removed because of the stability in the petroleum markets over the last 3 or 4 years.

I think this is an example though, and a very good example, of how improvements in technology will change vehicle design and propulsion systems in the future. I don't believe for 1 minute that GM, Chrysler, Ford, or AMC are unaware of these kinds of developments, however. We find that the consumer is very receptive to new technologies. They have had to and are aware of the diesel engine, front-wheel drive, turbo charging, fuel injection; all these terms are relatively new to the U.S. car driver. And the next fuel shock or the next interruption will automatically produce a demand for hydrogen-powered cars or even electric vehicles.

Senator MATSUNAGA. Mr. Flynn.

Mr. FLYNN. I basically agree that, if anything, falling petroleum prices over the last few years have discouraged research in alternative fuels. More generally, I would comment that there is a broad issue of research and development in the automotive industry that needs to be addressed. Again, I would call particularly to mind the situation of the small supplier. Lots of the technical innovations in the industry have come about through incremental gains provided by small companies—little mom and pop shops out in Michigan and Indiana and Missouri—and these have been very, very important to the industry.

But we are now facing areas of rapid technological change where that is not enough. And one big question is: Where will funds for that kind of research and development come from, whether it be in alternative fuels or in other areas?

Senator MATSUNAGA. Well, isn't that the question which faces the industry and maybe taken too seriously to the point of inaction?

Now, I am sure the Japanese face the same question, but they go ahead.

Mr. FLYNN. Yes, Senator. I think, though, if you will realistically look at the situation of the automotive industry, if the manufacturing cost difference is anything like it is reported to be, if the Japanese are selling their cars at the prices they are reported to be selling them in our market, then the Japanese companies right now are in a position where they have profits to invest in 5- and 10-year-ahead technology. But the American industry is being forced to invest to catch up; that is, a lot of the money that the American industry is making is going into plant replacement, equipment replacement, simply playing a catch-up game.

Senator MATSUNAGA. Well, my concern is that we seem to be playing a catch-up game, and I am confident that just as we taught the Japanese all that they know about the auto industry, we can continue to teach them if we will go ahead and take the initiative and be innovative. I think our lack of initiative has failed us in the last decade and decade and a half.

Mr. HEMPHILL. I think this is a very good point. What we found in the latter part of the 1970's in image toward the Big Four or Big Three in this country was that they were supplying consumers with cars that were smaller versions of larger cars. And to this day that is the problem that GM, Ford, and Chrysler have—they are big cars with smaller appointments and sizes attached to them. And they were not viewed as innovative or advanced.

It was only until recently when the new models have come out—the Tempo, Topaz from Ford, the K-cars from Chrysler—have been viewed as true improvements over—and Encore and Alliance—over previous models.

Senator MATSUNAGA. I am sorry, Mr. Chairman, I wasn't here during the testimony of the first panel—I was tied up in the Energy and Natural Resources Committee in a markup session. I certainly would have wanted to put the questions to the auto industry spokesmen this morning. I am sorry I wasn't here.

Senator DANFORTH. I think they will be back. [Laughter.]

Senator MATSUNAGA. Because otherwise, they will be asking you, Mr. Chairman, to introduce a bill again to impose a quota on foreign car imports on hydrogen engines.

Thank you.

Senator DANFORTH. Gentlemen, as I understand your testimony, you are on opposite sides on the effect of the demise of voluntary restraints. Is that right, Mr. Hemphill? You feel that restraints have been a minus for the auto industry and that we would be better off without them. And, Mr. Flynn, you feel that we would be inundated if they were to come to an end.

Mr. HEMPHILL. I think that's an accurate summary, net-net. We have not seen that voluntary restraints have helped the domestics

significantly. I think it would be very imprudent for the Japanese to flood the market with more and more volume. I don't expect the Japanese to follow what Chrysler has estimated, for example, in the big surge in imports that will follow voluntary restraints next spring. The Japanese are very comfortable penetrating market segments that are brand new to them, with their higher-priced and up-scale models that they have been able to introduce. And voluntary restraints stimulated them to hasten that along.

So, the Japanese are earning record profits, the dealers are earning record margins on the cars that they are selling, no one has to plan, no one has to worry about production, no one has to worry about distribution. It is really a comfortable situation for the Japanese. And, given the demographics of the domestic versus the Japanese import buyers, they are very different markets demographically, and not much crossover between the two at this point.

Senator DANFORTH. And Mr. Flynn.

Mr. FLYNN. I am not absolutely certain they would inundate us. But the Japanese auto industry that I just heard described sounds to me like Honda, Nissan, and Toyota, and there are a lot of other companies over there who have felt shut off by the VRA's, and who need the U.S. market to make some profits for the first time in a few years. I think the pressure that they will put on each other and on the Big Three in terms of the U.S. market is going to lead to a significant increase in Japanese market share.

Senator DANFORTH. My own thought is that if we do not extend the voluntary restraints there is still an unstated limitation, as indicated by Ambassador Brock's statement. You know, he indicated earlier he doesn't want an extension; but, on the other hand, he says that the administration would not stand by and let the U.S. auto industry go under. I think that that was pretty clear in 1981 and even before, with the Chrysler loan guarantee, before then, that we are more than willing to deviate from philosophy if we see a major industry that is on the slide.

Gentlemen, thank you very much for your testimony, and thank you especially for traveling such a distance to be with us.

Next we have Denis Healy, president of Turtlewax, on behalf of the Automotive Parts & Accessories Association; and Robert McElwaine, president, American International Automobile Dealers Association, Washington, DC.

Mr. Healy, thank you for being with us.

STATEMENT OF DENIS J. HEALY, PRESIDENT, TURTLEWAX, INC., CHICAGO, IL, ON BEHALF OF AUTOMOTIVE PARTS & ACCESSORIES ASSOCIATION, WASHINGTON, DC

Mr. HEALY. Thank you.

I didn't come so far; I came from Chicago.

Senator DANFORTH. From Chicago?

Mr. HEALY. That's not so far.

Senator DANFORTH. Well, thank you for being here from Chicago.

Mr. HEALY. I am Denis Healy. I am the president of the Turtlewax Co.; I am chairman-elect of the Automotive Parts & Accessories Association; I am the chairman of the International Trade Committee of that association; and I also chair the Automotive

Products Export Council—APEC. This is a pan-industry group of trade associations that acts as industry's link with government in recommending export promotion policy.

APAA, which is our association, is pleased to have again been invited to address the subcommittee to state our industry position and to present, in summary, a course of action which would ensure American firms their rightful place in the emerging world car market.

The American supplier industry is a mainstay of the national economy, in its domestic output and export performance, in its employment, and in its importance to national defense needs.

The competitiveness and productivity of domestic car makers and other key elements of the Nation's industrial base turn on our industry's continued vitality. It has been earlier stated by other speakers that the jobs involved in the supplier to the original equipment manufacturers and the after market is estimated at about 2 to 1. So this is a very, very important segment of our economy.

However, many factors have thrust our vital industry into a period of wrenching transition. Some of these factors are well known—domestic auto depression, moves by domestic auto producers toward world car production, greater foreign sourcing necessary to contain costs, and a shrinking domestic market. The critical challenge born of this transition is that American parts and accessory manufacturers must export if they are to survive.

Mr. Chairman, we have argued for the free flow of automotive products, be it the untethered foreign sourcing by U.S. automakers, or Japanese access to the American marketplace. But free trade cannot be a one-way street, as Japan and others would have it, barring American sales to both their original equipment and replacement markets.

We also have urged the swift defeat of local-content legislation, a proposal we feel will actually undermine our market position. APAA believes that we must put local content behind us and get on to the important business of saving the vital American automotive supplier industry.

To this end, we believe new policies must be in place before the Japanese voluntary restraint agreement ends—if indeed they do. It would be tragic if the Congress and the administration were lulled into believing that higher domestic car production spelled the end to auto industry woes.

Before pent-up Japanese automakers, sourced by capital-rich Japanese suppliers, unleash their cars on the American market, we urge the implementation of the APAA/APEC parts purchase incentive plan as a lever to pry open Japanese and other markets closed to American made original equipment and replacement parts.

The incentive for foreign manufacturers to buy American products would be a dollar of vehicle-duty credit for every dollar of American products purchased. This plan would save American jobs, equip foreign vehicle imports with American equipment, and set off a chain reaction of growth in aftermarket sales.

Congressional action on the array of policy recommendations we have made, particularly enactment of this parts purchase incentive plan, will see us through the transition and lead to a resurgence of

our manufacturing power and the restoration of millions of American jobs.

The livelihoods of 2 million American workers and the equity interests of millions of American entrepreneurs and shareholders are at stake. Our association stands ready, Mr. Chairman, to work with the members of this committee and others in Congress in the urgent business of helping our industry to meet its export challenge.

We appreciate this opportunity to present our views, and we would be happy to answer any questions you may have.

This is a summary of a written presentation we have submitted.

Senator DANFORTH. Thank you, sir.

[Mr. Healy's prepared statement follows:]

SUMMARY STATEMENT AND APPENDICES OF THE AUTOMOTIVE PARTS & ACCESSORIES ASSOCIATION, INC.

Mr. Chairman and Members of the Subcommittee:

I am Denis Healy, President of Turtle Wax, Inc. and Chairman of the Automotive Parts and Accessories Association's International Trade Committee. I also chair the Automotive Products Export Council (APEC), a pan-industry group of six major trade associations that acts as industry's link with government in recommending export promotion policies.

APAA is pleased to have again been invited to address the Subcommittee on the state of our industry, and to present a course of action that would ensure American firms their rightful place in the emerging world car market.

The American supplier industry is a mainstay of the national economy -- in its employment, its domestic output and export performance, and its importance to national defense needs. The competitiveness and productivity of domestic auto makers and other key elements of the nation's industrial undergirding turn on our industry's continued vitality.

But many factors have thrust our vital industry into a period of wrenching transition, namely: the domestic auto depression, moves by domestic auto producers toward world

car production, greater foreign sourcing necessary to contain costs, and a shrinking domestic market. The critical challenge, borne of this transition, is that American parts and accessories manufacturers must export more if they are to meet their bottom lines.

Mr. Chairman, we have argued for the free flow of automotive products, be it the untethered foreign sourcing by U.S. auto makers, or Japanese access to the American marketplace. But free trade cannot be a one way street, as we have demonstrated Japan and other countries would have it, barring American sales to both their original equipment and replacement markets.

We also have urged the swift defeat of local content legislation, a proposal that actually would undermine our market position. APAA believes that we must put local content behind us and get on to the important business of saving the vital American automotive supplier industry. To this end, we believe new policies must be in place before the Japanese Voluntary Restraint Agreement ends. It would be tragic if the Congress and Administration were lulled into believing that higher domestic car production spelled the end to auto industry woes.

Before pent-up Japanese auto makers unleash their cars on the American market, sourced by capital-rich Japanese

suppliers, we urge the implementation of the APAA/APEC Parts Purchase Incentive Plan as a lever to pry open Japanese markets to American-made original equipment and replacement parts.

The incentive to buy would be a dollar of vehicle duty credit for every dollar of American products purchased. Our Plan would save American jobs, equip foreign vehicle imports with American equipment, and set off a chain reaction of growth in aftermarket sales.

Congressional action on the array of policy recommendations we have made, particularly enactment of the Plan, will see us through the transition and lead to a resurgence of our manufacturing power and the restoration of jobs and plant utilization.

The livelihoods of two million American workers and the equity interests of millions of American entrepreneurs and shareholders are at stake. APAA stands ready, Mr. Chairman, to work with the Members of this Committee and others in Congress in the urgent business of helping our industry to meet its export challenge.

We appreciate this opportunity to present our views and would be happy to answer any questions you may have.

APPENDIX A

SIZE OF THE AUTOMOTIVE AFTERMARKET

RETAIL SALES DOLLARS[1]

Size of the Automotive Aftermarket in 1979 (in billions of 1979 retail dollars).

Replacement parts	
Batteries	2.59
Brakes	
Drums & Rotors	.19
Friction Materials	.87
Brake Hardware	.07
Hydraulic Parts	.47
Chassis	
Exhaust System	1.70
Shocks	.77
Steering and Suspension	.51
Drive Train	
Axles	.64
Transmissions	.99
Joints	.37
Clutch	1.08
Electrical	
Wire and Cable	.64
Parts	2.84
Filters	
Air	.59
Oil	1.03
Other	.34
Spark Plugs	.97
Replacement glass	.71
Other Replacement Parts*	19.96
Chemicals	
Functional Fluids	1.03
Maintenance Chemicals	.63
Appearance Products	.50
Tires	11.60
Motor Oil	2.75
TOTAL	$53.39

*Includes engines and engine accessories, miscellaneous crash parts, lamps, radios, accessories and air conditioning.

	(Establishments)
NUMBER OF FIRMS	
VEHICLE PARTS AND MANUFACTURING[2]	
Motor Vehicle Parts and Accessories	2,610
Truck Trailers	351
Automotive Stampings	579
	3,540
WHOLESALING	
Automotive Parts Wholesaling[3]	28,750
Motor Vehicles, Tires & Tubes[4]	10,164
	38,914
REPRESENTATIVES	
Total Representatives[5]	3,000
RETAIL OUTLETS[6]	
AUTOMOTIVE RELATED	
Service Stations	150,100
Tire Stores	14,800
Other Auto Supply	28,600
Other Automotive	27,100
AUTO SPECIALTY REPAIR	12,800
OTHER AUTO REPAIR	97,900
OTHER AUTOMOTIVE OUTLETS	
Discount Stores	6,900
Department Stores	2,700
Grocery Stores	83,600
Drug Stores	13,400
Variety Stores	5,900
Hardware Stores	17,800
Other Outlets	29,300
TOTAL RETAIL OUTLETS	471,100
EMPLOYMENT[7]	
VEHICLE & PARTS MANUFACTURING	1,645,000
VEHICLE SALES & MAINTENANCE	
Wholesaling	423,175
Retailing	1,710,832
Selected Services	483,191
Highway Construction Maintenance	803,699
Related Industry (Petroleum)	281,625
LOCAL TRANSPORTATION & TRUCKING	9,381,777
TOTAL EMPLOYMENT	14,729,299

SOURCES

1. Automotive Market Research Council
2. Motor Vehicle Manufacturers Association
3. Automotive Service Industry Association
4. U.S.Bureau of the Census and The American Trucking Associatic
5. Automotive Chain Store Magazine
6. Automotive Parts & Accessories Association
7. U.S.Bureau of the Census

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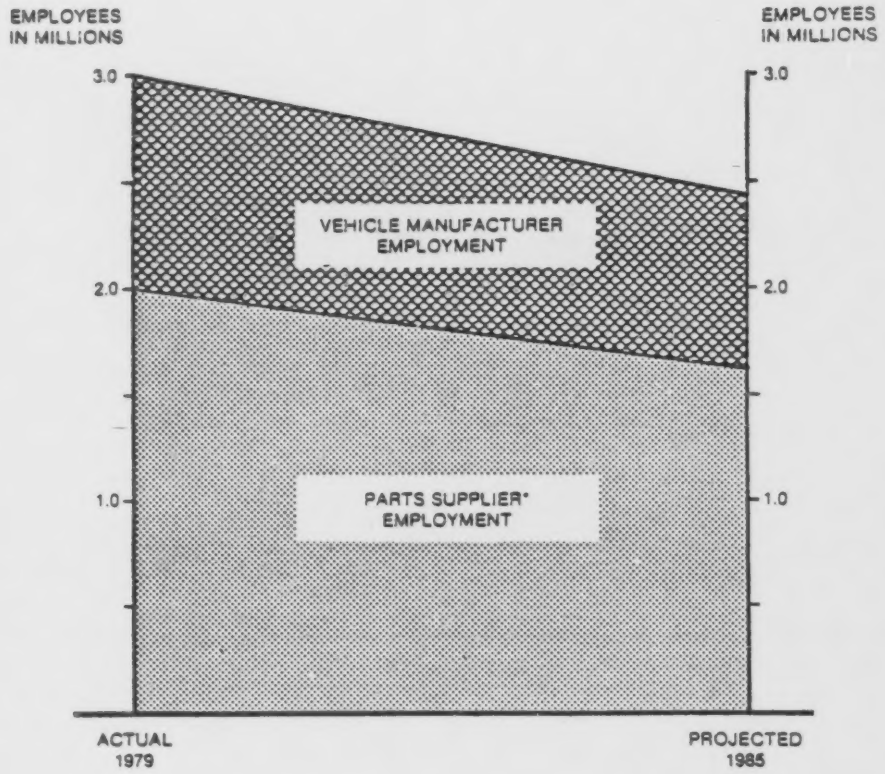
APPENDIX B

PROJECTED U.S. EMPLOYMENT FOR U.S. VEHICLE MANUFACTURERS AND PARTS SUPPLIERS



SOURCE: Worldwide Competitiveness of the U.S. Automotive Industry and Its Parts Suppliers During the 1980's; Arthur Anderson & Co., February 1981

* INTERQUARTILE RANGE FOR 1985 PROJECTIONS 2.0-2.3 PARTS SUPPLIER EMPLOYEES FOR EACH VEHICLE MANUFACTURER EMPLOYEE

APPENDIX C

STATEMENT OF

JULIAN C. MORRIS

PRESIDENT

OF THE

AUTOMOTIVE PARTS AND ACCESSORIES ASSOCIATION, INC.

PRESENTED

TO THE COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION

UNITED STATES SENATE

MAY 16, 1984

Mr. Chairman and Members of the Committee:

My name is Julian Morris, and I am the President of the Automotive Parts and Accessories Association (APAA). I am pleased to have the opportunity to meet with you today and to present APAA's reasons for opposing The Fair Practices in Automotive Products Act (S 707).

APAA is a trade association located in Washington, D.C., comprised mainly of 1500 manufacturers, independent manufacturers' representatives, distributors, and retailers of automotive parts and accessories sold primarily, but not exclusively, in the "aftermarket." The aftermarket consists of products manufactured for and service provided to automobiles by manufacturers, distributors, and retailers that are independent of the original auto manufacturers (the "OEM market").

The aftermarket is vital to this nation's economy, providing at least double the employment of the vehicle manufacturers and their dealers. In matters affecting the automotive industry, however, we often are overlooked due primarily to our size, numbers and geographical distribution -- we are hundreds of thousands of medium and large but mainly small manufacturers, retailers, distributors, and sales agents located in every state of the Union producing and selling domestically in excess of $54 billion of parts, accessories and chemicals annually. Appendix A to my statement provides more details about the aftermarket.

Industry firms also play a key role in the nation's export performance and balance of trade, exporting some $10 billion of automotive products in 1983.

And, as has been demonstrated by past mobilization efforts, the automotive supplier industry plays a crucial role in national defense.

INDUSTRY IN TRANSITION

The American parts and accessories industry continues to suffer the consequences of more than four years of depression in the domestic automobile industry. With sales of domestic passenger cars still well below 1978 pre-recession levels, and with historically unprecedented deferral of auto repairs and maintenance by the public, our financial position in aggregate is not healthy.

Japan's auto makers have exacerbated our industry's crisis by including little or no U.S. content in vehicle exports that not only dominate world markets but seized a hefty 20.4 percent share of the American new car market in 1983. Japan's lock on its original equipment market, in turn, has foreclosed our firms' penetration of the lucrative replacement parts market in Japan, the U.S., and third countries.

These conditions have resulted in soft sales and the idling of many plants and people in an industry where operating under capacity is most unusual.

From its peak in 1978, the real value of domestic parts and component producer shipments have dropped 38 percent. Profits have fallen so dramatically that the Commerce Secretary's 1982 report on the industry found the after-tax return on sales of 17 larger firms studied skidding from 4.8 percent in 1978 to 1.5 percent in 1982.

Plummeting supplier industry output has resulted in at least 100 underutilized plants closing between 1978 and 1981. This data -- the most up to date available -- only tells part of the story. The Transportation Secretary's 1981 report concedes that "available information on auto-related layoffs and plant closings in the supplier sector is less complete than for the prime (auto) manufacturers."

As American firms close their plant gates forever, the consequences have been most tragic for our firms' employees. Two studies conducted for the 1981 industry report indicate that "approximately 500,000 U.S. supplier jobs have been lost due to the industry downturn, with over 90 percent of those job losses concentrated in the industrial Midwest states."

These dramatic findings are corroborated by the 1981 Arthur Andersen study of the competitiveness of the U.S. industry and its parts suppliers. The chart, which I have attached as Appendix B, depicts a drop of 500,000 supplier jobs from a 1978 peak and projects the permanent loss of 400,000 supplier jobs by 1985 if present economic trends continue.

High interest rates continue to play a major role in the automotive products industry's financial dilemma. Just last week, the nation's major banks hiked their prime lending rate to 12.5 percent, the highest rate since October, 1982. The long period of capital market instability has hurt all firms, but especially those thousands of small businesses who are forced to finance their long term debt needs with volatile short term debt instruments.

Our firms want to invest substantial capital in efficient, less costly production facilities in order to grapple with increasingly effective foreign competition. A 1982 Commerce Department industry study forecasts that capital starved U.S. auto makers will source an increasing share of their original equipment parts from independent manufacturers and projects "greater participation by suppliers in the vehicle manufacturers' product development programs."

This reaffirms the conclusion of the Secretary of Transportation's 1980 report to the President on the automobile industry that: "In their move to economize, the leading automakers will be leaning heavily on suppliers for research and engineering development necessary to produce the better quality and less costly components of the future." The report adds that "suppliers unable to upgrade their facilities, take risks, or sponsor research will lose out to suppliers with competitive advantages of efficiency, size or technical know-how."

The industry desperately needs capital to engineer, design, and tool for new products; to adapt existing products for the latest model vehicles and cope with the proliferation of parts that comes with burgeoning proliferation in models from around the world. All of this must be accomplished at competitive prices and with the assurance of a return on investment.

JAPAN THREATENS INDUSTRY SURVIVAL

We believe, Mr. Chairman, that the very survival of our industry hinges on American success in cracking the Japanese original equipment and

replacement markets. We intend to demonstrate that far from helping our firms gain access to these markets, S 707 would actually doom our objectives.

But, as surely as we believe that S 707 must be defeated, we also are pleased that it has helped focus Congressional attention on the high cost of Japan's restrictive practices to U.S. automotive suppliers.

We believe that the Congress must explore and develop remedies to the injury Japanese practices have inflicted on our industry. This is especially important, given the fact that Japan's Voluntary Restraint Agreement (VRA) on automobile exports may end next March, opening the U.S. market to countless more imports with little or no American value added.

We would like, therefore, to introduce here a thorough discussion of Japanese automotive trading practices as background information for Members who wish to formulate viable solutions to this vital industry's problems. Left unchecked, these practices will prevent the capital formation our firms need to avoid a tragic downward spiral of noncompetitiveness.

In 1960, the U.S. produced over 52% of the cars made worldwide; Japan produced only 1.3%. In 1970, the U.S. share had fallen to 29%; Japan was up to 14%. By 1980, Japan had passed us as the frontrunner of car producing nations with over 24% of the world market; we were down to under 22%.

The unnatural growth in productivity and price competitiveness of the Japanese auto parts industry is not simply a function of optimal management practices and production techniques. The Japanese vehicle manufacturers have a long established family relationship with most of their parts suppliers consisting of interlocking directorships and equity positions, under the aegis of the Central Bank's traditional practice of selective access to credit. This has resulted in a highly nationalistic, in-bred, protected and virtually impenetrable vehicle manufacturer-supplier environment in that country.

Harbridge House Vice President John B. Schnapp has researched the "really close, symbiotic relationships between the vehicle makers and their principal suppliers." According to Schnapp, "these relationships are manifested in investments, in loans, and in technological interchange." He adds that very often the auto makers "own more than token equity positions in their leading suppliers" and frequently act as a "source of loan capital to their suppliers and as a technological resource."

With "families of vendors surrounding each of the principal auto makers," Toyota and Nissan, Mr. Schnapp concluded that "there are relatively few truly independent parts makers."

With the title of the world's Number 1 auto producer under their belt, the Japanese have now set their sights on usurping our position as the world's leading parts producer. It plans to reach that goal in the 1980's according to a 1980 report by its Long Term Credit Bank.

Decades of protectionism, such as amazingly low tax rates, enormous asset depreciation and deferred taxes for costs of developing new export markets, kept competitors at sea. The Japanese government in a 1979 publication entitled Your Market in Japan: Automotive Parts and Accessories describes in part its nationalistic production incentives and industrial targeting:

> Developing and upgrading the means of transport is indispensable for the development of a country. Therefore, from the late 1950's on when the future of Japanese industry began at long last to look brighter, both the Japanese government and industry made an all-out effort to develop and nurture the motor vehicle industry.
>
> The auto-parts industry in particular had to be cultivated and strengthened as it is the foundation of the auto industry as a whole. At the outset, the Japanese auto-parts industry was a sector with a large number of small-size and financially weak firms. But with the help of various government measures, such as the Law for Temporary Measures for Promoting the Machinery Industry enacted to foster and strengthen fundamental industrial sectors in the machinery industry in Japan, the Japanese auto-parts industry achieved rapid growth.

These policies have paid off for the Japanese.

The toll for being locked out of the aftermarket for Japanese vehicles in Japan, here and in third countries has risen considerably in recent years

as the worldwide car population fills increasingly with Japanese vehicles. In 1960, Japan exported 4.2% (7,000 units) of their domestic vehicle production. Today the Japanese export over 36% or nearly 4 million vehicles. By contrast we export less than 9% of our domestic production. More than 46% of the Japanese cars exported in 1980 ended up within the borders of the U.S. Only 1% of our U.S. car exports were able to penetrate Japan's home market.

U.S. NEGOTIATORS ATTEMPT TO OPEN ORIGINAL EQUIPMENT MARKETS

With the very survival of the aftermarket industry hinging on success in entering the Japanese original equipment and replacement markets worldwide, we applauded government efforts that led Japan to issue its 1980 Orderly Marketing Agreement for parts trade. A key element was a Japanese parts purchasing mission to the U.S. in September, 1980, and the subsequent Japanese commitment to purchase $300 million in American original equipment in 1981, with significant increases promised thereafter.

Although the huge $1 billion parts trade deficit with Japan in 1980 made the $300 million look somewhat anemic, nonetheless APAA welcomed the promise as a potentially important first step to better market access. Regrettably, the Japanese fell far short of even this modest goal.

Commerce Department figures for 1981 showed only $119 million in U.S. parts sales to Japan, a nominal increase over 1980's figure of $109.8 million, but a major step backward when adjusted for inflation. Japan, on the other hand, enjoyed auto related sales in the U.S. exceeding $1.8 billion in 1981, leaving the U.S. in a deficit position of more than $1.6 billion.

Even more distressing is the fact that the much publicized tariff reductions on automotive products nearly exclusively covered labor intensive items that did not appear on the list targeted for purchase. Rather, the list that continues to interest Japanese auto makers includes energy intensive items such as glass or aluminum and from year to year their purchases of these products hover near the $100 million mark.

Most regrettably, Japan used its Voluntary Restraint Agreement on autos to excuse itself from its parts purchasing commitment and reneged on its commitment to meet with U.S. negotiators during 1981 and 1982 to monitor the mission's progress. Quite expectedly, the Commerce Department 1982 survey of U.S. firms that sought Japanese business showed the mission to be an exercise in futility. Exports to Japan in 1982 were a paltry $128 million. I have attached as Appendix C the complete set of the department's survey findings.

We contend and the Commerce Department backs us up that this staggering imbalance is not caused by the lack of quality or price competitiveness on the part of U.S. made products. Nor can the root of the problem be attributed to a strong U.S. dollar, high interest rates or U.S. apathy in developing the Japanese market.

The fundamental cause is Japan's longstanding policies and practices which encourage exports and discriminate against imports.

In spite of the recent demise of the Japanese import duty, the delivered prices of foreign vehicles in Japan remains significantly high. This is

due to the import bias which tinges the Japanese commodity taxes; a tax which exempts exports but is imposed on imports. Then there are the certification requirements, local distribution methods, and road taxes which discriminate against the larger engines of U.S. models.

These obstacles combined with a panoply of other non-tariff barriers against U.S. origin parts -- including the withholding of parts specifications developed behind doors closed to us; an unwieldy parts approval system; and that uniquely strong alliance between vehicle and parts makers -- generally have conspired to prevent outside competitors from penetrating the walls of their safe and secure world. I have attached as Appendix D my 1980 testimony before the Senate Select Committee on Small Business detailing specific cases of non-tariff barriers.

Despite the numerous waves of Japanese trade liberalization promises to hit over the last two years, industry analysts have found little of value for the U.S. automotive and related industries. In fact, Japan's 1983 proposal to simplify vehicle import inspection actually drew fire from U.S. industry. General Motors President F. James McDonald concluded that instead of facilitating auto trade, the inspection and certification changes "actually favor Japanese models more now than before." Due to the structure of the new rules, McDonald argues that low-volume sellers such as U.S. auto makers "would incur huge cost penalties if we were to use these more liberalized procedures." Despite the fact that the U.S. exported only 3,562 passenger cars to Japan in 1982, down from a scant 7,742 in 1981, Japan is reluctant to reciprocate on the self-certification to safety and noise requirements afforded its exports to the U.S.

It would appear that negotiations and agreements have not substantially changed the sad state of U.S.-Japan trade relations. Our manufacturers still face a general inability to penetrate the Japanese original equipment market.

EFFORTS TO OPEN AFTERMARKET FAIL

As the world fills with Japanese-made vehicles bearing little or no American equipment, American aftermarket suppliers are faced with constricting global replacement markets. Leading to further replacement market erosion is the unusually strong hold Japan's car makers have on their dealers in the U.S. and world markets, whereby they are coerced to stock only Japanese-made service parts.

Aftermarket barriers in the U.S. alone cost American suppliers billions of dollars in lost sales opportunities for items such as batteries, lights, fan belts, starters, tires, and so on. Attacking this market means so much to the vitality of our industry that American negotiators insisted that steps to open the dealership network be a component of Japan's Orderly Marketing Agreement. As with the other elements, it proved meaningless. When the Department of Commerce allowed to lapse the task of monitoring the original equipment purchases, the aftermarket issue became a casualty of neglect.

Letting Japan off the hook on its promise to open the dealership network was further exacerbated by a highly inaccurate Japanese commissioned study that said the independents' share of the import market in the U.S. was growing so fast that nothing more need be done. APAA fought for industry's

right to review the study which was locked inside the Commerce Department for several months. Once APAA secured the study, we refuted it with our own critique which we have shared with the Administration and Congress. Our comprehensive analysis of the study is attached as Appendix E.

As former Assistant Secretary of State Robert Hormats testified in 1981 "this market (U.S. aftermarket) is one in which U.S. firms should be able to compete actively and successfully. But it has been very hard for American firms to penetrate this market, and Japanese firms appear reluctant to fully cooperate with them, while Japanese parts sell vigorously." Hormats added that Japanese claims of poor U.S. price and delivery simply do not apply when dealing with American suppliers on their home turf. Yet, a Department of Commerce suggestion to have U.S. made parts certified so that dealers of Japanese vehicles could purchase them has met with stiff Japanese resistance.

JAPANESE PRACTICE CLOSED DEALERSHIP NETWORK

Clearly, Japan's auto makers intend to foist on the U.S. and other markets the same closed distribution web it has woven for its home market. Indeed, in Japan there is almost no independent aftermarket as we know it. Harbridge House executive, John Schnapp, has cited the 1981 edition of Guide to Japan's Auto Parts Industry that concludes "the independent distribution channel is weak in comparison with vehicle dealer organizations." According to Schnapp, the author, Mr. Kenji Okochi, whose export company represents parts makers, describes the "reasons for this peculiar phenomonon." Chief among reasons offered is "that each vehicle maker signs an exclusive contract with the parts maker which may allow him

to control the production of parts applications for his vehicle." By way of contrast, the U.S. aftermarket for domestic vehicles is so open that a 1980 study by A.T. Kearney revealed that only 18% of parts sales for GM passenger car applications were realized through franchised GM dealers.

Ironically, the closed distribution network has victimized Japanese parts makers who see a good thing in our open marketplace but do not know how to get at it. Mr. Schnapp describes their quandary:

> On the one hand, they recognize that the structure of our market is vastly different from the replacement parts market in Japan, and they see the need to adapt their own strategies to the differences existing in the American Market. On the other hand, there are very strong pressures on them to avoid straining the relationships that they have created with their only customers who would like, of course, to channel most of the American sale of replacement parts through their own franchised dealers, much as they currently have succeeded in doing.

Still, Japan's parts makers have a leg up on our firms -- tooling economics. Without the volumes assured by original equipment orders and faced with a proliferation of Japanese new car model series, it is virtually impossible for our firms to achieve the economies of scale

necessary to produce economically for a particular application. The net effect is the exportation of our plant capacity and jobs to Japan.

APAA is encouraged by the growing Congressional awareness of the problems we have discussed. We believe that the House Energy and Commerce Committee report on the 1982 legislation, HR 5133, truly went to the heart of the problem:

> The Committee regards the failure of foreign automakers to purchase more American-made auto parts very seriously. As a result, Section 7 of the bill directs the Secretary of the Department of Transportation and the FTC to conduct a study to determine how to increase the use of American-made new and replacement parts by foreign manufacturers. The Committee intends for representatives of U.S. auto workers, parts manufacturers and vehicle manufacturers to be consulted in the development of this study.

We are especially gratified that the committee sensed not only the dangers of the closed U.S. aftermarket but seized as well on the critical question of how we might increase our sales of original equipment to foreign manufacturers. Unless these markets are opened, much of our industry's plant capacity and as many as 400,000 of the supply sector's half- million unemployed will remain permanently idled.

MEETING THE JAPANESE CHALLENGE

At first blush, one might think the current domestic auto making recovery will solve everything -- no need to worry about Japan if there is plenty of demand for American original equipment and replacement parts. While we are pleased by the stepped up pace of domestic production, we would caution that even in this supposedly strong year, auto sales are projected to rise to just 10.5 million units -- including 2.5 million imports. We conclude that the industry's transition and the forecast for its future spell a very incomplete solution to the problems of American parts and accessories manufacturers.

Industry analysts tell us that we will not again see the days when American parts and components were demanded for the production of 12.6 million autos and light trucks. In fact, the Delphi forecast released this year by Arthur Andersen, the University of Michigan and the Michigan Manufacturers Association projects 1985 domestic production at 10 million units and 10.5 million cars produced domestically in 1990.

The strength and duration of the domestic companies' recovery, according to Chase and other analysts, depends on their success on the battleground of small car competition. However, estimates of losses of as much as $1,000 on every subcompact sold by the Big Three and small car assembly plants operating well below capacity -- despite below cost pricing -- may lead to an untenable solution: U.S. auto makers may hire Japan to build their small cars.

The Commerce Secretary's 1982 industry report comments on this possibility:

...the auto firms will continue to face the

> reality of the Japanese manufacturing cost advantage. Responding to this cost advantage during a period of limited financial reserves has been particularly difficult. GM's plans for small cars illustrates one possible path the companies may take. GM has agreed to import 200,000 small cars annually from Isuzu starting in 1984 to market in this country. In addition, GM may bring in up to 100,000 mini-cars annually from Suzuki. When these two agreements are combined with GM's joint venture with Toyota to assemble 200,000 small front-wheel drive cars annually, the company will be able to market 500,000 modern Japanese-type cars annually with minimal capital investment.

Should General Motors carry through with these initiatives, competitive market forces will undoubtedly dictate similar small car sourcing strategies by Ford and Chrysler. We are however encouraged by the attention that long-suffering U.S. auto makers have drawn to the basis for Japan's advantage, shown by studies to be $1,500 to $2,000 per car.

Ford Chairman Philip Caldwell has charged that Japanese tax policy and the undervalued yen account for as much as $1,300 of the so-called advantage. Japan's commodity tax raises the price of cars sold in Japan, including imports, by 17 to 22 percent. The rub is that cars built for export have

the tax rebated, in effect doubling the advantage -- a tax disparity worth $500 to $600 per car.

Add to this the undervalued yen, and Japanese manufacturers gain an added automatic advantage over American car makers of $600 to $700 per car. For too long a weak yen has made U.S. automotive products exported to Japan far too expensive and drastically reduced the cost of Japanese imports. And of course we are placed at a severe competitive disadvantage when competing with the Japanese in third markets.

Economists agree that to remove the disparity we need to see the yen move down to 200 to the dollar or less. At present it is trading at about 240 to the dollar, giving Japanese manufacturers a whopping 20 to 25 percent price advantage.

We would ask that this Committee and others in Congress join us in urging the Reagan Administration to redouble its efforts in the U.S.-Japan Ad Hoc Committee on the Yen-Dollar to negotiate a resolution of this unacceptable disparity with the Japanese.

Finally, on the matter of cost advantage, Harbour and Associates determined in a 1982 study that just in time production accounted for $550 of the $2,200 cost advantage held by Japan in subcompact car production. A stronger U.S. supplier industry could provide similar savings to domestic car makers and help avert the exportation of U.S. small car production.

We recognize that the entire discussion of Japan's cost advantage could prove moot, if in the absence of Japan's export restraints, competitive pressures drive U.S. auto makers to import their small car lines.

LOCAL CONTENT REQUIREMENTS WOULD RETARD U.S. ROLE IN WORLD MARKETS

Whether or not the U.S. forfeits small car production, the limited domestic auto making recovery and the Japanese challenge jeopardize our industry's future health. The proponents of S 707 contend that the legislation is the needed prescription for our industry.

We do not want the cure, it would only worsen the malady. APAA believes that in the process of attaining the bill's purported objectives of curbing foreign sourcing by U.S. auto makers and encouraging foreign auto making investment in the U.S., the recovery prospects for U.S. auto makers and suppliers would be shattered.

We are concerned that the bill's more stringent content test for U.S. auto makers -- imposed from the outset -- would damage their competitive posture in both domestic and foreign markets. S 707 disregards the emerging world car developments of the last decade that wrought a previously unforeseen and still largely ignored network of partnerships among car companies around the globe. These joint ventures and alliances (e.g., GM-Isuzu-Susuki, Chrysler-Peugot-Mitsubishi), were born of enormously high capital costs for the need to secure for participants both new vehicle types and components, and new markets.

One of the effects of this new era is an increase in vehicle and parts sourcing outside the U.S., particularly in areas with attractive low labor rates. In many of these countries (e.g. Mexico, Brazil) stringent local content demands guarantee that a preponderance of the products made will end up as exports. As a result, it is highly likely that in the years ahead the U.S. will experience an even greater influx of foreign sourced vehicles and components, and once traditionally American emblems will adorn vehicles made elsewhere in the world.

Every industry analysis we have seen supports the Secretary of Transportation, who in his 1980 report on the U.S. automobile industry projected that U.S. auto makers will "increase overseas parts sourcing from the present less than five percent to 10 percent by 1985 and 15 percent by 1990." The Delphi forecast of Arthur Andersen et al. sees the percentage of foreign-sourced parts going to 25 percent as early as 1987. Attempts to modify the decision-making behavior of U.S. firms by legislative fiat would jeopardize their strategy of reaching greater economies of scale necessary to contain production costs.

U.S. manufacturers must have complete flexibility in deciding how they will build competitively priced cars needed to command their rightful share of U.S. and foreign markets. The alternative is to be trapped in an ever-downward spiral of lower production and sharply curtailed demand for American made original equipment and replacement parts.

Foreign firms benefiting from relaxed content requirements over the three year phase-in could capture even more ground in the battle for American

market share. While hamstringing the component purchasing practices of American manufacturers, foreign firms could source freely, and they most assuredly would widen their production cost advantage. When we consider as well the floodgates that will open when the Voluntary Restraint Agreement ends, we believe those three years will prove especially damaging to American auto making and parts manufacturing.

Parenthetically, APAA disagrees with the assessment made in 1983 before the House Energy and Commerce Committee by United Auto Workers officials that the bill would not affect American aftermarket manufacturing. APAA's objections to domestic content are made from our perspective as a representative of both original equipment and aftermarket suppliers.

It is ironic enough that the UAW misjudged the ramifications for hundreds of thousands of union and non-union workers in the supplier sector, but even more so that they fail to see the danger to the core of their constituency, auto making workers. Workers in both sectors would lose as U.S. car makers were forced into a less competitive posture. And, Japanese investment in U.S. auto making facilities certainly promises to be no panacea for organized labor. In fact, those Japanese companies now producing in the U.S. have shown an aversion to collective bargaining. The same holds true for the United Kingdom, where Japanese owned assembly facilities remained unorganized after eight years of operation, despite the powerful union movement there.

Attainment of the legislation's second objective, the encouragement of foreign investment in U.S. auto making facilities, would also prove

inimical to our interests. While American firms have selected a decentralized world car strategy, sourcing certain components from around the world, Japan has charted a centralized course that calls for building its world car at home. The Secretary of Transportation's 1980 report on the industry described Japan's strategy as:

> ...taking advantage of their domestic labor force, achieving low cost production through closely coordinated, tightly integrated and centralized production facilities, and then shipping the product around the world. Although assembled in other countries, even Japanese knock-down kits are dominated by Japanese made parts.

Once fully phased in, a number of analysts agree that many foreign firms could meet the content requirements without increasing their purchases of American parts and accessories. MIT auto analyst Martin Anderson has calculated that a number of foreign firms with relatively low sales in the U.S. "could collectively expand their imports by 1 million units with no added American content." Thus, a number of Japanese car makers, now stymied by the export restraint, could gain in our market while adhering to their world car strategy.

Making the situation even more grim for our industry are the potential responses S 707 might evoke from the behemoths of Japanese auto making, Toyota and Nissan. Should these and other larger firms choose to extend their presence into the U.S., we foresee little appreciable increase in

their purchases of American made parts and accessories. This presence would not begin and end at the assembly line. Rather, foreign owned assembly lines would be fed by Japanese parts plants and the well established network of native suppliers. From this standpoint, we believe that the strict local content provisions of S 707 are undesirable. Under more balanced conditions, we would have little to fear from increased foreign competition within our borders. However, our current precarious industrial position puts us at a competitive disadvantage and renders a vital U.S. industry vulnerable to foreign domination.

In its report, "The Automobile Industry in the 1980's," issued in May, 1981, the Long Term Credit Bank of Japan boasted that during the 1980's Japan will become the world's leading supplier of auto components. The report claims that "the export ratios of most of the independent auto component companies will rise, and some of them are setting up production abroad. Even component companies which are subsidiaries of auto companies, especially those producing standardized components are developing their exports. Some of these companies have announced plans to go abroad with their parent companies."

Former Assistant Secretary of State for Economic Affairs, Robert Hormats, testified in 1981 that the Honda auto factory in Ohio and the Nissan truck plant in Tennessee were "expected to procure initially about 40% of their inputs, by value, from U.S. suppliers, with the possibility of future increases in such procurement." We have cause to fear that even these modest levels of U.S. content will not be attained. Already Honda has announced plans for certain Japanese suppliers to open plants near the Ohio

factory. By way of explanation, Honda complains that it can not find adequate price competitive U.S. supply sources and is forced to revert to home suppliers.

In the case of one U.S. firm which sought Honda business, Commerce officials revealed that the 40 percent price differential between the Japanese and U.S. competitors was simply a function of the quantities requested from the U.S. firm. The lot size discussed with the American company was so much smaller than orders placed with Japanese sources that legitimate price comparisons are impossible.

And in early 1982, it was announced that the Japanese tire company, Bridgestone, had acquired a large Firestone truck tire plant in Nashville. The $52 million purchase sets the stage for the Japanese tire company to become the original equipment supplier of tires for 120,000 light trucks that Nissan Motors plans to build annually at its plant in that state. The Firestone plant, under-capacity because of a depressed market for U.S.-built light trucks, was an easy mark.

Should large firms decide that it is not cost-effective to undertake production in the U.S., the legislation would be tantamount to an import quota. Local content laws violate the General Agreement on Tariffs and Trade (GATT), and we believe that those victimized by such a law would be on solid ground in bringing a case of injury before the GATT Council. The recent GATT panel ruling that the domestic sourcing requirements of Canada's Foreign Investment Review Agency (FIRA), challenged by the USTR,

were inconsistent with the agreement supports the likelihood of a successful challenge being raised against a U.S. domestic content law.

A finding against the U.S. would result either in our having to negotiate a massive settlement for the loss of trade or the victims would be freed from the treaty to retaliate. Since exporting is a dire necessity to sustaining the future health of our industry, we are especially vulnerable. Retaliatory steps could take a tremendous toll as well on other industries vital to our nation's economy. Because protectionism only breeds more protectionism, we subscribe to analyses that show a local content law resulting in a net loss of 70,000 American jobs by 1990.

Rather than violating the law, our government ought to actively police other nations whose content laws rob Americans of jobs. Mexico, for example, boasts that its content requirements will boost Mexican parts exports from $640 million in 1979 to over $5 billion by 1985. Some 60 percent of these exports will head for the U.S. market, translating into the equivalent of 86,000 to 115,000 jobs in the United States auto and auto parts industry, according to a 1981 report by the U.S. Labor-Industry Coalition for International Trade. Interestingly, the Coalition, comprised of nine labor unions and seven corporations, strongly condemned performance requirements in all forms and urged the U.S. government with all due speed to resolve such inequities through GATT or other dispute settlement mechanisms available.

CONCLUSION

In conclusion, we would first like to commend the Committee for its interest in the myriad of problems we have presented. Many factors have thrust our industry into a period of dramatic transition, namely: the domestic auto depression, moves by domestic auto producers toward world car production, greater foreign sourcing necessary to contain costs and a shrinking domestic market.

The critical challenge, borne of this transition, is that American parts and accessories manufacturers must export more if they are to meet their bottom lines.

We have shown that S 707 would thwart our export objectives, while simultaneously undermining our position in the domestic original equipment and replacement parts markets. The bill's harmful effects on our industry's sales and workers would be staggering.

American consumers also would lose if S 707 forced U.S. auto makers, and in turn, parts producers into a downward spiral of producing fewer cars and parts at higher unit costs. And, should the legislation effect a quota, consumers would face limited choices and sticker shock.

Mr. Chairman, we have argued for the free flow of automotive products, be it the untethered foreign sourcing by U.S. auto makers, or Japanese access to the American marketplace. But, free trade can not be a one way street, as we have demonstrated Japan would have it.

We have shown that S 707 is not the solution to the restrictive Japanese practices threatening our industry's survival, and we seek its swift defeat.

APAA believes that we must put local content legislation behind us and get on to the important business of saving the vital American automotive supplier industry. To this end, we believe new policies must be in place before the Japanese Voluntary Restraint Agreement ends. It would be tragic if the Congress and the Administration were to subscribe to the simplistic sentiment that higher domestic auto production means nothing more need be done.

Before pent-up Japanese auto makers unleash their cars -- sourced by their capital-rich Japanese suppliers -- on the American market, we must develop a lever -- some means -- to pry open Japanese markets to American-made original equipment and replacement parts.

The livelihoods of at least 400,000 American supplier workers and the equity interests of millions of American entrepreneurs and shareholders are at stake. APAA stands ready, Mr. Chairman, to work with you, the Members of this Committee, and others in Congress in the urgent business of developing viable, responsible solutions to our industry's problems.

We appreciate this opportunity to present our views and would be happy to answer any questions you may have.

APPENDIX D

1982 Department of Commerce Survey

U.S. Auto Parts Mission Participants

Introduction

This report summarizes the results of a third and final survey of U.S. companies that participated in the 1980 Japanese Automobile Components Purchasing Promotion Mission to the U.S.A. The final survey consisted of 40 phone interviews by two senior analysts with business backgrounds. The analysts asked specific questions related to the mission follow-up activity, and encouraged candid comments by the interviewees on their impressions of the mission and doing business with the Japanese.

Results

The majority of the U.S. participants reported a lack of Japanese business resulting from the mission. The participants were not optimistic about the possibility of future contracts for original equipment for automobiles built in Japan. There was some optimism by a few U.S. manufactures for supplying parts to Japanese firms with U.S. production facilities. These manufacturers planned to pursue this domestic business. Sixty-three percent of the participants interviewed no longer carry on follow-up activities with Japanese companies for business in Japan. However, these companies indicated they would like to do business with the Japanese and would not turn down inquiries received from Japanese companies.

Two firms contracting with a Japanese auto manufacturer said they could not relate this business directly to the mission.

Conclusions

Survey results suggest there is less activity taking place now than in 1981, and there is pessimism about future sales by U.S. manufacturers. There is little evidence to suggest the $300 million sales forecast of 1980 will ever be reached.

The attitude of participants in 1982 was unchanged from attitudes expressed in December 1980. Comments varied from mild pessimism to cautious optimism. It would appear that neither the Japanese nor the U.S. firms are pursuing potential business relationships with much enthusiasm or expectation of success.

Recommendations

The U.S. Government should assist our manufacturers in supplying U.S. domestically produced Japanese automobiles and trucks.

Japanese Auto Parts Buying Mission

U.S. firms surveyed felt the following issues should be brought to the attention of U.S.-Japan Trade Facilitation Committee:

- The Japanese Government and automobile manufacturers are not convinced that doing business with U.S. firms is in their best interest.

- The Japanese can arrange to under-price U.S. firms when they request a package of products.

- The Japanese are trying to promote their suppliers to set up in the United States for aftermarket.

- The Japanese are likely to import only small consumer disposables, e.g. toothpaste, coca-cola.

- The Japanese must eliminate the "closed, good-old-boy" system for suppliers.

- The value of yen compared to dollar must be considered, and addressed when discussions with the Japanese are held.

Attachme

Now.

SECOND COMMERCE DEPARTMENT SURVEY
OF
U.S. AUTO PARTS MISSION PARTICIPANTS

The second survey indicates that U.S. participants are neithe satisfied with the progress made to date nor optimistic about the possibility of future developments. Even though 86% of the U.S. respondents are presently in contact with the Japanese firms represented on the mission, 49% believe these contacts have not b productive, 39% believe them to be somewhat productive and only 1 feel they have been very productive.

Survey responses reveal that since the first survey 73 price quotations have been requested and 42 post-mission negotiations a currently taking place. However, only 5 new contracts have been signed, 11 contracts are currently under negotiation, and 2- sample orders have been placed--10 of which are for the same product. T mission to date has generated approximately $5.5 million accordin to survey respondents. Included in this figure is the $4 million sales reported in the first survey.

RESULTS

This survey yielded responses from 63 of the 73 representati who participated in the September 1980 Mission. The 63 responde represent 41 different U.S. companies. The results from their completed questionnaires are summarized in the table below.

Mission Results

	Export		Aftermarket		T
	Firms	Items	Firms	Items	
Contracts Signed	3	4	-	-	
Contracts Currently Under Negotiation	7	10	1	-	
Sample Orders Placed	8	24	--	--	
Price Quotations Requested	22	73	--	--	
Post-Mission Negotiations Taking Place	11	36	2	6	

Follow-up survey results reveal that fewer U.S. companies are presently negotiating with the Japanese firms than were negotiati at the time of the first survey. Only a handful of new price quotations have been requested and prototype orders placed since t first survey. These results suggest that much less activity is taking place now than was occuring six months ago. Results are especially disappointing for the U.S. aftermarket on Japanese cars Although 40% of the mission participants are presently involved i this market, very little activity is taking place. Only one contract has been signed, one is currently under negotiation and 6 post-mission negotiations are taking place.

QUALITATIVE FINDINGS

There is an overall feeling from the U.S. participants that t Japanese are global-minded only as far as selling their products. However, they are divided on the use of government assistance to stimulate U.S. auto parts sales. Some firms believe that the political tension is hindering the signing of contracts, while others feel that the Japanese firms would not have any incentive show even a limited amount of interest without some government participation. Inspite of all the pessimistic feeling portrayed the U.S. respondents, the majority continue to have contact with Japanese firms represented on the mission.

One possible cause for optimism is that 14 U.S. companies anticipate signing future contracts as a result of current discussions with Japanese firms on 16 product items within the ne 2 years. Of these firms, the average number of months from the completion of the mission to their estimate of the contract sign. is 18 months. The product lines on which these contracts may be signed are broad in scope.

Many of the surveyed firms feel that the Japanese manufacturi companies are not serious about buying U.S. parts and that they s an interest only because of pressure exerted from both the Japane and U.S. Governments. According to the U.S. parts manufacturers, the Japanese automotive firms appear to be satisfied with their d domestic suppliers. Some of the U.S. respondents state that the Japanese firms are "protecting" the suppliers with whom they have close domestic ties. In some cases these ties are in the form of equity or complete ownership arrangements. U.S. firms who are experienced exporters mention that this is a particular problem because they do not only have to penetrate an export market, but also a much stiffer one, the Japanese domestic market. A general impression of the U.S. mission participants is that Japanese companies are seeking to disqualify firms who do not meet their needs rather than find firms that do.

Japanese quality control standards continue to present a probl to about 38% of the responding U.S. firms. Most of these firms believe that the Japanese companies are very demanding since they will not allow products to deviate from exact specifications even equal or superior to the requested part. Additionally, some U.S. suppliers believe that they are given insufficient lead time to ma. quality changes asked for by the Japanese.

PROBLEMS ENCOUNTERED IN THE EXPORT MARKET

The most crucial problem encountered by more than 65% of the U.S. mission participants continues to be their inability to quote acceptable prices to Japanese companies. Reasons for this problem include import tariffs, the continued weakening of the yen vis a v the strengthening of the dollar, and most importantly, the cost of transportation. According to the U.S. participants, it is almost

impossible for them to compete with the domestic Japanese parts suppliers when shipping costs are added to their domestic manufacturing costs. This is particularly true in the automobile industry where many component parts are very heavy (e.g. transmissions) or very delicate and thus require special shipping arrangements (e.g. windows and other glass parts).

Most price quotations submitted to the Japanese companies ha been rejected. A few U.S. firms have suggested that a solution t this problem would be to install parts in the Japanese cars at th U.S. port of entry. However, other firms feel that the problem only be solved by the manufacture or at least assembly of Japanes cars in the United States.

PROBLEMS ENCOUNTERED IN THE AFTERMARKET

Of the 20 U.S. respondents selling to the U.S. aftermarket fo Japanese automobiles, 8 have encountered problems. The problems cited can be combined into one primary concern. U.S. respondents voiced concern about the special agreements which exist between t Japanese auto manufacturers, their U.S. auto parts distributors a the Japanese U.S. car dealers to encourage the purchase of Japanese-made parts in the U.S. This matter is currently being investigated by the Federal Trade Commission (FTC). In the opini of these respondents, the Japanese prefer to use their own channe of U.S. distribution because they appear to mistrust American sal partnerships.

Attachment

February 1981

INITIAL COMMERCE DEPARTMENT SURVEY
OF
U.S. AUTO PARTS MISSION PARTICIPANTS

The results from the survey conducted by the Department of Commerce suggest that the majority of the U.S. participants are satisfied with the initial business contacts resulting from the mission. Though the U.S. firms caution that it is too early to judge whether significant sales will result, the majority of the firms are optimistic about the potential results. A minority are, however, much less optimistic, believing that the Japanese firms a not pursuing potential business relationships with much enthusiasm

Initial discussions between U.S. and Japanese companies are under way on a wide range of product lines, but few contracts have been signed so far. Participants who responded to the survey reported $4 million in sales. This small amount is not surprising at this early date. Nevertheless, these results indicate that considerable effort lies ahead if U.S. auto parts to Japan are to increase the roughly $200 million in 1981 that had been forecast b the Japanese mission participants in September 1980. (Some of th increase will be exports of U.S. companies not participating in the mission.)

Since the mission was not the first business contact with Japanese companies for most of the U.S. participants, these resul can not be solely attributed to the mission. The companies reporting sales all indicate that prior negotiations were under wa Nevertheless, the comments of the participants suggest that the mission was beneficial to the furthering of their negotiations.

RESULTS

The initial survey yielded responses from 54 of the 73 representatives who participated in the mission. These 73 participants represent 54 different companies. The results from their completed questionnaires are summarized in the following data table.

Mission Results To Date

	Number	Firms	Participat
(1) Contracts Signed	5	5	5
(2) Dollar Sales	$4 million		
(3) Contracts Currently Under Negotiation	28	8	11
(4) Sample Orders Placed	23	10	12
(5) Price Quotations Requested	91	28	40
(6) Post-Mission Negotiations	93	33	44

NOTE: The above data represent only those results of participants who responded. If additional participants' responses are received, these results will be reflected in subsequent reports.

Based on the reported results, the post-mission period appear to be off to a good start. As the above table shows, activity is occurring in all stages of the business process, from initial U.S. contact with Japanese firms to the actual signing of contracts. Of the 54 reporting companies, only 9 reported no business dealings. The bulk of the reported activity is occurring in the preliminary business stages, e.g., plans for post-mission negotiations and requests for price quotations. This is to be expected at this early date since it generally takes considerable time for an automobile component purchasing contract to be finalized.

The level of activity in the preliminary stages is encouraging at this time, however, we would expect subsequent surveys to show much greater movement toward completed contracts and actual sales.

QUALITATIVE FINDINGS

The U.S. firms generally saw the mission as a good opportunity to continue the dialogue begun prior to the mission as well as to initiate new contacts. The tables indicate that most U.S. participants have continued these discussions with their Japanese counterparts beyond the conclusion of the mission. However, almost unanimously the U.S. participants warn that it is still too early to tell whether these discussions will prove to be productive in the long run. A typical comment from the participants is "...further negotiations are being conducted but nothing conclusive has occurred to date."

A minority of the participants (approximately 20%) have a more pessimistic attitude toward the accomplishments of the mission. In their opinion, the Japanese firms have not exhibited genuine interest in doing business with them and are only going through the motions of negotiating with them because of pressure exerted by both the Japanese and U.S. Governments. Typical comments: "May be lack of serious inquiries in many cases" and "We have the distinct impression that the Japanese companies present were merely satisfying U.S.A. pressure on trade relations."

The U.S. participants are, for the most part, satisfied with the timeliness and sufficiency of the responses provided by the Japanese firms to their questions. There were only a few complaints of receiving incomplete information from Japanese firms. In turn, the U.S. firms reported little difficulty in responding to the inquiries made by the Japanese firms. Additionally, almost all of the U.S. participants who have established contact with the Japanese firms are planning follow-up activities over the next six months. These companies report that they plan to continue contacts both in the United States and Japan with the Japanese automobile manufacturers. Future trips to Japan are also planned by many companies.

Comments made by the U.S. participants reflect a realization that final sales will not come easily. The problem of greatest concern to the U.S. participants is their ability to quote prices acceptable to the Japanese companies. A factor mentioned frequently by the respondents as contributing to the problem is

associated costs. Of the fifteen U.S. participants who had recei a response to their price quotation, the majority were told their price was too high. Some U.S. participants indicated they are requoting or are investigating the reasons why their quotes were considered too high.

The second area of concern is quality control standards requi by the Japanese manufacturers. In the opinion of some U.S. participants these standards are not reasonable and prohibit U.S. parts from successfully passing the Japanese product performance tests. Additionally, some U.S. participants believe that they ar given insufficient lead time to make the product modification requested by the Japanese firms.

METHODOLOGY

Immediately following the conclusion of the buying mission, International Trade Administration (ITA) evaluation specialists began to design a questionnaire which would measure both the U.S. participants' impressions of the mission and the amount of busines generated by the mission. After discussions with the Japanese Government to ensure some comparability in survey methods and form the questionnaire was finalized and sent to the 73 representatives of U.S. firms who participated in the mission.

These participants, who represented primarily large companies involved in the manufacture of components for the automobile industry, were not all originally scheduled to meet with the trade mission. Of the 73 representatives, only 43 actually participated in the mission in response to ITA recruitment efforts, while the remaining 30 representatives were contacted directly by the Japan automobile firms and met with the Japanese representatives during the second week of the mission. The 73 participants represent a total of 54 different companies.

This report was based on the 59 written responses and the five additional telephone responses received to date. The responses received represent 88% of all participants and 85% of all the companies participating in the mission. Subsequent reports will include any additional responses which are received.

APPENDIX E

TESTIMONY

OF THE

AUTOMOTIVE PARTS AND ACCESSORIES ASSOCIATION

PRESENTED BY JULIAN MORRIS, PRESIDENT

BEFORE

THE SENATE SELECT COMMITTEE ON SMALL BUSINESS

CONCERNING

NON-TARIFF TRADE BARRIERS TO SELLING IN THE JAPANESE MARKET

July 25, 1980

I am Julian Morris, President of the Automotive Parts and Accessories Association. APAA is a national organization represent nearly 1,500 manufacturers, wholesalers, warehouse distributors and retailers involved in bringing motor vehicle equipment, accesso and vehicle related chemicals to the consumer and professional installation market. The majority of our manufacturer members are engaged in exporting, although few have been successful in cracking the Japanese market. I am here to share some of their frustrating experiences with you.

"THEY SHALL NOT PASS"

In this case, we are not talking about an insurmountable mountain peak but the inability of American products to secure landing space in Japanese markets.

Trading companies and distributors have erected well constructed barriers where few imports can penetrate. And, in the opinion of American exporters affiliated with the Automotive Parts and Accessories Association, they are being aided and abetted by the Japanese government.

In fact, our exporters are firm in their belief that no matter how low Japanese tariffs become, there will be no appreciable flow of American products in the discernible future to Tokyo and other ports of entry.

According to APAA manufacturers we have consulted, Japanese distributors have utilized a wide variety of strategies to keep American products off limits. Accuracy testing, product quality standards and debilitating delaying tactics are among the exercises that make it all but impossible for Americans to sell in this market.

We have collected a formidable body of evidence demonstrati that the Japanese are really playing hard ball. Let us begin with the experiences of an American manufacturer of anti-freeze testing equipment that is going nowhere with our so-called Japanese trading partner. Sales of this high quality equipment is in the millions of units in the U.S. market -- and the product has passed government and consumer tests with flying colors.

It is significant that the company became interested in the Japanese market as a result of numerous inquiries from Japanese retailers. The product is able to test the ability of anti-freeze solutions to perform properly in weather as low as 10 degrees below zero. The company researched the market in 1974 and became convinced that its testers were of a higher quality, better designed and more durable than similar products selling successfully in Japan.

Company representatives contacted small and medium sized Japanese distributors to see if they would handle the product. One distributor tested 100 units, an unusually large number since one or two suffice. These units had an accuracy variance of 3/4 to 1 degree which is a highly acceptable performance for other markets. But the product was rejected by the distributor because it couldn't attain 100 percent accuracy in all cases.

The company then tried another distributor. Its proposal made the arduous route through a total of 26 executives. Yet after many frustrating months the proposal was rejected. One of the reasons given was that it would have to be priced too high for the Japanese market. This didn't jell with pricing information the company received from Japanese sources.

In 1978, the company tried again. This time, the pricing climate seemed conducive since the yen was soaring and the dollar plummeting -- but the results were the same as before. No sale. No explanation.

Now, I would like to read you excerpts from a letter sent to us from another APAA member firm.

"Our company is the world's largest manufacturer of tire valves and builds its valves to an international standard and is approved by most all automobile and tire companies outside of Japan.

"In early 1973, we submitted valves meeting international standards for their approval. From that time on it has been one request after another for drawings, changes in design, additional samples, etc. Often we seemed to approach their specifications only to have them changed.

"We have made numerous sales calls and engineering calls to obtain their approval of the product. In doing so we found that the Japanese industry standards are different from the worldwide standards even though their representatives attend the International Standard Organization meetings on tire valves, at which international standards have been established.

"The product in question in this case was a tubeless tire valve to be used on vehicles exported to the United States. In order to conform to Japanese specifications our company would have violated the ozone standards and other specifications of the U.S. regulatory agencies, the Society of Automotive Engineers, the California Department of Transportation and the general requirements of the tire companies and the car companies in the United States."

Let me quote this executive again -- "In January, 1979, our Works Manager made a second visit to Japan to finally clear up any engineering details that were in dispute. At that time a new specification was introduced -- which was to mark the valve in such a manner that the lot in which that valve came from could be identified in case of a recall requirement. It had taken 8 years for our company to 'come close' to meeting their specifications."

We have included as a supplement to this testimony, the chronology of events over these last eight frustrating years. This is his conclusion: "It is the technical people who have put the difficulties in front of us and I consider that their many requirements to meet Japanese standards are the obstacles, and not necessarily the tariff barriers."

I also have testimony from a battery testing equipment manufacturer who has experienced the same vexing ritual of testing, standards, specifications and interminable delays.

He tells us: "We sell less than $50,000 per year in Japan and based on what we are doing in other countries like England, Germany, France and even places like Hong Kong and Taiwan we should probably be shipping to Japan at least five or six hundred thousand dollars worth of our products at factory selling price.

"Our biggest problem is that the Japanese will not accept UL approval or independent U.S. laboratory approval even when we comply with Japanese specifications. Products must be tested in Japan.

"I'd like to cite some examples. We have a product rejected because the Japanese say that the packaging is objectionable. We ask for an explanation. They say it is hard to explain -- too many language barriers. We return to the drawing board and change what he thinks may be objectionable. After many months we receive word the changes do not relate to the objectionable elements. We discuss the situation further but never succeed in finding what it is they are objecting to.

"The Japanese sometimes refuse a product because they claim the price is too high. However, the manufacturer knows he can bring the price in under or at the lower end of the products already on the market. When apprised of this, the Japanese rejoinder is that because it is an import, people will think it ought to be priced higher for prestige purposes, hence the Catch 22 argument that the price will be too high.

"Alternatively, the Japanese will placate the seller by accepting the product and then pricing it out of the market.

"One of our biggest problems is that the Japanese will not accept UL approval even when we comply with Japanese specifications. Products must be tested in Japan.

"This can take years. You send them a unit for testing. Then months go by. After many letters, telexes and phone calls, you are finally told the product failed the test. You request information on what caused the failure. They are unable to give you an explanation.

"If you ask what voltage was used in the test -- the reply is 'standard' voltage. But they are unable to define 'standard' voltage and promise to mail you the information at a later date.

"In the meantime, they request two additional battery testers and explain the original testers were destroyed while testing.

"This time you stipulate that the new samples be tested one at a time so if one is destroyed the second can still be tested to the point prior to the destruction of the first tester. You also request that it be returned so that you can have a better idea of what the failure mode is. However, the Japanese either destroy both samples or claim they lost the second tester. This goes on and on and on.

"You can waste years trying to crack the Japanese market. It takes thousands of dollars in telephone calls and telexes. If you go there to meet with them the cost of living kills you. Typically, it costs $200 a day for hotel accommodations, $100 for food and $2,000 for air fare per person. Days can run into weeks and months. Usually the entire trip is wasted and you find yourself back home negotiating by phone and telex."

This is his conclusion: "The only way our industry, or any industry in the United States is going to successfully penetrate the Japanese market and help defray the huge imbalance of payments we have with Japan, is for us to get the cooperation of the official and unofficial Japanese government and entities that we have to deal with in exporting. Until they agree that they are going to cooperate and really 'play fair' with us in this matter, we are going nowhere and will never meet with any large degree of success in this area."

Amen.

6-17-80
F. S. IRLINGER

BRIDGESTONE TIRE VALVE APPROVAL PROJECT
CHRONOLOGICAL ENGINEERING EVENTS

10-25-72	H. R. PRASAD MEETS WITH BRIDGESTONE IN THEIR TOKYO OFFICE B. S. INFORMS SCHRADER OF THEIR APPROVAL REQUIREMENTS.
APRIL, 1973	SCHRADER VALVES SUBMITTED TO B.S. FOR APPROVAL
9-8-1973	SCHRADER INFORMED BY B.S.THAT VALVES MUST MEET J.I.S.
12-1973	SCHRADER DECISION TO MAKE DWGS. AND MANUFACTURE PROTOTYPES TO J.I.S.
1-1974	SCHRADER TR 413'S (U.S.A.) SUBMITTED TO B.S.
2-8-1974	SCHRADER SUBMITTED 50 TR413'S TO B.S.
4-18-1974	SCHRADER TOLD BY B.S. THAT APPROVAL MAY COME BY END OF 1974
5-9-1974	SUBMITTAL OF TR 78 AND TR 89 "EQUIVALENTS" TO B. S. BY SCHRADER
6-14-74	SUBMITTED THE FOLLOWING TO B.S.: (20) TR 218 A'; (20) TR LN-10; (20 TR CH3).
8-29-1974	SUBMITTED (20) TR 13 TO B.S.
10-16-1974	LETTER FROM IKEGAMI: RESULTS RATHER GOOD
11-14-1974	B.S. APPROVAL OF SECOND SAMPLE SUBMISSION (APPLICATION APPROVAL) B.S. NOW WAITING FOR ADDITIONAL (50) PIECES EACH OF TR 413, TR 78A AND TR-89 FOR PRODUCTION TESTS.
2-6-1975	FORWARDED (55) TR 89 EQUIV. TO B.S.; ALSO (44) TR 13'S
2-11-1975	FORWARDED (49) TR 78 A EQUIVALENT TO B.S.
8-8-1975	INFORMED BY IKEGAMI THAT B.S. IS SETTING UP NEW "PURCHASE RULES" FOR SCHRADER (NON -B.S. STANDARD) VALVES. APPROVAL PROCEDURE TO START ALL OVER AGAIN.
AUG.,1975	KILMARX VISIT TO JAPAN
MARCH, 1977	SUBMITTAL OF 6069 CAPS IN BLACK TO B.S.
6-27-1977	B.S. CRITICAL ON SCHRADER'S DIMENSIONING OF PRODUCT DRAWINGS
9-14-1977	RESUBMITTED RE-DIMENSIONED DWGS TO B.S. PLUS 6069 CAP TEST DATA
12-16-1977	B.S. APPROVAL ON SCHRADER TTV FOR DOMESTIC A.M. AND OVERSEAS FACTORIES WITH "MINOR" QUALIFICATIONS.
1-13-1978	B.S. PRESENTS TO SCHRADER "B.S. VENDORS BASIC CONTRACT".

2-24-1978	SCHRADER/U.S.A. SUBMITS TO SCHRADER/JAPAN SCHRADER/BRIDGESTONE AGREEMENT.
4-3-1978	SCHRADER TRACE BACK SYSTEM SENT TO B.S.
6-23-1978	SCHRADER TRACE BACK SYSTEM REJECTED BY B.S.
7-18-1979	SCHRADER 6069 CAPS DISAPPROVED BY B.S.
1-26-1979	KILMARX TRIP TO JAPAN
7-3-79	IRLINGER AND IKEGAMI ARRANGED FOR DRAWING CORRECTIONS REQUESTED BY B.S.
7-17-78	DICKSON MEETING REVIEW: B.S. SPECS & PLANNED COURSE OF ACTION (NEW MOLDS, ETC) TO MEET BRIDGESTONE SPECS (FRENCH CAP)
7-19-79	INFORMED IKEGAMI CHANGES ARE NO PROBLEM
7-20-79	FROM IKEGAMI; B.S. CHANGED DIM'S ARE ACCEPTABLE
7-20-79	ORDERED DWGS AND SAMPLES OF FRENCH CAP
8-1-79	REQUESTED LAB MATL SPEC. FROM FRANCE FOR IKE.
8-22-79	STATUS REPORT AND DELIVERY SCHEDULE MAILED TO IKE
9-13-79	AQL (BS) MEETING HELD W/QC - PROGRAM SET UP & IKE NOTIFIED.
9-14-79	SAMPLE MOLD INSERT ORDERED
9-24-79	TEST PROGRAM AND ADDITIONAL BS INFO FINALIZED
9-27- 79	SAMPLE COMPOUND AND TEST DATA SENT TO IKE
10- 79	SAMPLES OF SEVERAL COMPOUNDS PRODUCED AND TESTED
10-5-79	REQUESTED B.S. SAMPLING PROCEDURES
10-28-79	TEST RESULTS ANALYZED
11-29-79	IKEGAMI NOTIFIED TESTING COMPLETED
12-17-79	TEST COMPARING B.S. AND PACIFIC PRODUCTION TO SCHRADER INPROCESS. SAMPLES OF TR 413 SUBMITTED TO B.S. LATER 2001-72 COMPOUND TESTS NOT AS GOOD AS ORIGINAL (BS SAMPLES)
2-29-80	PACIFIC VS SCHRADER QUALITY AND PERFORMANCE REPORT ISSUED
3-20-80	BS 413 VALVES ESTIMATED BY DICKSON ($156.72/M + 9,500 TOOLS
6-3-1980	REPORT FROM BS: SCHRADER/USA BRASS QUALITY ACCEPTABLE; SCHRADER COMPOUND 2001-72 ACCEPTABLE FOR FIRST ORDER ONLY; 1.ORDER OF 300,000 MAY BE FORTHCOMING.

APPENDIX F

THE AUTOMOTIVE PARTS AND ACCESSORIES ASSOCIATION ANALYSIS

OF THE REPORT ON

SERVICE PARTS FOR JAPANESE VEHICLES IN USA

BY THE JAPAN AUTOMOBILE MANUFACTURERS ASSOCIATION

5100 Forbes Blvd. Lanham, Maryland 20706

38-638 O - 84 - 11

CHAPTER I. JAPANESE VEHICLE REPLACEMENT PARTS MARKET IN THE U.S.

Section 1. Japanese Vehicle Population in the U.S. -- present & future

A. New Vehicle Registrations (Exhibit 1-1)

Page 3, Line 2 Cites Exhibit 1-1, sources: Automotive News and JAMA. Shows growth in Japan's market share of new cars from 16.8% of new cars in 1979 to 21.3% in 1980. As JAMA notes, this 21.3% share of the new car market sets a record level.

Comment: The report should not include VW and other imports. They do not pertain to the report's stated intention "to conduct research to define the actual state of the parts after-market for Japanese-made cars in the U.S." (Page 2, Line 9-10)

Line 5-8 Notes that the 20% decline in domestic sales "can be considered to account for the overall rise in the share of Japanese vehicles."

Comment: No explanation or evidence is given to substantiate such a cause-effect relationship.

Furthermore, although mentioning the relationship of the sharp Japanese increase to the precipitous U.S. decline, no mention is made that VW declined 27% and "other imports" were down 8%.

No breakdown is made for "other imports" totaling 390,795 units.

B. Vehicle Population (U.I.O. - units in operation) (Exhibit 1-2, 1-3)

Line 10 Cites Exhibit 1-2. The pie chart shows three Japanese auto makers holding a joint total share of the import vehicle population of 40%. A significant 37.3% share is held by unnamed "other" imports. VW holds a 22.7% share.

Comment: Exhibit 1-2 proves very unsatisfactory for purposes of the Japanese vehicle discussion.

VW's 22.7% share appears in order to make the three Japanese auto makers' share look smaller.

Lines 11-12 Cites estimates that total U.S. car park in 1980 stood at 142 million units, including 11 million Japanese units (8.1% share).

Lines 13-14 Notes "projecting 5 years ahead," total car park should grow to 163 million units (a 21 million unit increase), with 18 million Japanese units (10.9% share

Comment: No specific source is given for who is "projecting" the 1985 Japanese share or for the 1980 estimates cited.

Lines 16-17 The report laments that "when compared to the registration of new vehicles, the share of Japanese vehicles (10.9%) in the total U.S. vehicle population is still at a low level."

Comment: These figures in no way portray the depth of the Japanese market penetration. If indeed, one accepts a growth of 21 million units by 1985, and 7 million units (one-third) of that growth is attributed to Japanese vehicles, one begins to sense the scope of market trends. These figures illustrate visions of much higher market shares than the record 21.3% share held in 1980.

Exhibit 1-3, offered to support the above, has no specific source attributed to it. It shows the share of other imports slipping between 1980 and 1985, from 4.7 million units in operation to 2.1 million units, a decline of 55.3%, while Japan will increase its units from 11.4 million to 17.8 million.

Comment: This is interesting in light of the previous use of VW and "other" imports to make Japanese shares of total imports look smaller.

Exhibit 1-3 also dramatically understates the Japanese share of units in operation in 1985.

In accompanying charts, trucks are counted twice to make the grand total of vehicles in operation larger. For 1985, the chart breaks down Japanese vehicles into 12 million cars and 5.8 million trucks. The figure for imports actually counts the 5.8 million trucks in the total for cars. Thus, when U.S. domestic cars of 100.8 million and the 19.9 million imports are added, total cars is 120.7 million. Then, when counting trucks, the same 5.8 million Japanese trucks are added to 36.2 million U.S. domestic trucks, for a total of 42 million trucks. Therefore, the grand total of cars and trucks is overstated by 5.8 million units, and should actually be 156.9 million. Using this smaller total, the share of Japanese

11.3%, a very significant increase. The figures for 1980 are also overstated, and the actual Japanese vehicle share should be 8.24% instead of 8.1%.

Lines 18-19 Report a "review of the top four imports (VW, Toyota, Datsun, and Honda) shows they account for 63% of total U.S. imports."

Comment: The only pertinent information should be the 40% share held by the three top Japanese auto makers, and the breakdown of the 37.3% "other" to show Japanese vehicles.

C. Change in Vehicle Age (Exhibit 1-4, 1-5)

Lines 21-22 States "the age of the vehicle population is a key factor in determining the size and structure of the total replacement parts market."

Lines 22-25 Compares the average age level of "VW at 8 years" with the relatively younger U.I.O., of Toyota and Datsun at 5 and the Honda at 3 years."

Comment: Report once again clouds the issue by including VW in the analysis.

Lines 25-26 The above claims to show "that the replacement parts market for Japanese vehicles has not yet matured.

Comment: No explanation offered as to how this is shown.

Lines 27-28 Contends: "In terms of the age of U.I.O., vehicles over 2 years old are the most influential in creating parts demand."

Comment: If one accepts this, there should already exist strong parts demand due to significant numbers of Japanese vehicles averaging 5.2 years in age.

Lines 28-29 Cites "figures for Japanese U.I.O. in 1980, 75 million units (65.8%) are over two years old."

Comment: This text and its supporting Exhibit 1-4 leave the most pertinent information unstated. Unmentioned is that 68% of Toyotas, 66% of Datsuns, and 56% of Hondas are over two years old. So many vehicles are well over two years old that their respective average ages are: Toyota (5.2) Datsun (5) and Honda (3).

Exhibit 1-4 breaks down the various makes of imports to show the weighted share each has in the total import park over two years old.

Comment: The text nowhere notes that of the total import car park over two years old, 29.8% are Toyotas and Datsuns. This means that 68% of Toyotas and 66% of Datsuns account for nearly 30% of the entire import car park over two years old. Indeed, there is already significant maturity.

Exhibit 1-4 cites "others", but gives no breakdown. In this case, 38.3% are labeled "others." Of the total 5,989,000 "others", nearly 75% fall in the over two years old category, and the average age for these vehicles is 6.1 years. Left unstated is how many of these are older Japanese units.

Lines 29-32 Envisions in 1985 "13.7 million units (77%) of the projected Japanese U.I.O. will be two years old or older. This is an 83% increase."

Comment: This glowing picture of the future is held out as if there were no significant maturity already. No mention is made of how the 1985 projections will change things materially.

As for the "83% increase", it is a rather dubious use of figures. The rate of change which is of concern is the 11.2% in percentage of units 2 years or older. This real percentage change is 17%, far different than an 83% increase. And, when looking at it from the perspective of absolute shares in a market, it is an absolute percentage change of 11.2%, from 65.8% to 77%.

Never attributes information to a specific source but lists JAMA and their contractor, Management Perspective as two of the three sources.

Sectio 2. Replacement Parts Market for Japanese Vehicles in the U.S present & future

A. Replacement Parts Market Size in the U.S. (Exhibit 1-6)

1. Present - 1980

Page 4, Line 1 Bases discussion on Exhibit 1-6. After showing in other exhibits a declining share for other imports this exhibit shows an increase for the replacement parts market for both imports and Japanese vehicles. The size of the replacement parts market for Japanese vehicles is seen growing from $1.06 b. in 1980 to $1.30 b. in 1985. The total figure for imports is seen climbing from $2.56 b. in 1980 to $3.31 b. in 1985

The pie charts and accompanying table show a replacement par market for Japanese vehicles in 1980 of $1.06 b. (3.1% of the total market). Of this amount, the dealers' share is $0.53 b. (1.6% of the total market). The total Japanese market and dealers' shares are to grow respectively to $1.80 b. (4.3% of total market) and $0.72 b. (1.7% of total market), in 1985.

Comment: One is to believe that of the $0.74 b. in projecte growth, only $0.19 b. of the increase will be attributed to the dealers (growing from $0.53 b. to $0.72 b. So, while they now have a 50% share in 1980, by 1985, their share is expected to decli to 40%.

The table shows the "imports" replacement market growing from $2.56 b. in 1980 to $3.31 b. in 1985, a change of $0.75 b. If this is to be believed, then of the total import increase of $0.75 b., Japanese vehicles will account for $0.74 b. of it, or all but $0.01 b. (for other imports). What imports are included here? All imports as before? The figures are very suspect.

Lines 3-4 "It is expected" that the total 1980 market for replacement parts will amount to "$34.6 b. on a retail basis

Comment: The report fails to note who specifically "expects" this.

The report also fails to credit specific sources for the projections in Exhibit 1-6, even though JAMA and its contractor, Management Perspective are two of three sources cited.

Lines 5-6 "In this total, the replacement parts market for Japanese vehicles is estimated at $1.06 b."

Comment: Again, there is no firm source cited for this estimate; no study cited to show it.

Lines 7-8 "As this constitutes a 3.1% share of the total replacement parts market, it can be said that the market for Japanese vehicle replacement parts is still small."

Comment: By whom can this be said? After all, the Japanese are supplying replacement parts for their cars. The issue is how much of the business U.S. firms have, and that can truly be said to be small.

2. Future - 1985

Lines 10-11 "The total replacement parts market is projected to expand 20% over the next five years to reach a value of $41.5 b. (retail)."

Comment: Again, there is no specific substantiation for these figures. There is no explanation, either, for why in this period of expansion (20%) would all other imports gain only $0.01 b. of the total $0.75 b. gain for imports.

Lines 12-13 "The replacement parts market for Japanese vehicles is projected to amount to $1.8 billion in 1985."

Comment: Again, no adequate source is provided for the projection.

Lines 14-16 Claims a projected Japanese "expansion of approximately 70% in five years and represents a market share increase of 1.2 percentage points from 1980 to reach 4.3% of the total replacement parts market which is still a comparatively small ratio."

Comment: No substantiation is advanced for the projected expansion.

There is no mention of the implications for other imports.

The lament that they will still have "a comparatively small ratio" in no way detracts from the tremendous projected increase in sales.

Lines 17-18 Claims the Japanese dealers' share will be "only 1.7% of the total replacement parts market in the U.S." a decline in its percentage share.

Comment: No study is advanced to prove the projected dealer decline at a time of such large increases.

B. Replacement Parts Market Size and Share by Sales Channel -- present & future (Exhibit 1-7, 1-8)

1. Present - 1980

Lines 23-26 "Of this total ($1.06 billion, 1980) it is estimated that Japanese dealers have a market share of 50-55% (A.T. Kearney).

Comment: While citing JAMA's contractor, Kearney, no study is cited for Kearney's findings. This same deficiency applies to the other figure of "45-50% or $550 million of the replacement parts market sold through independent repair shops and other retail distribution outlets outside the car dealer channel."

Lines 27-28 "In general, U.S. domestic car dealers account for 13% of the total parts sales for U.S. domestic makers in comparison with the already mentioned 30-35% share of Japanese car dealers."

Comment: What is meant by "in general"? Who is the actual source for this information, and what basis? Specific information is needed.

Lines 29-31 The two factors cited for this difference are "the low level of Japanese vehicles in the total U.S. vehicle population and that the age of the Japanese U.S.C. is still relatively young."

Comment: Using the Japanese standards, a vast number of their vehicles in our car park are not young making for very specious reasoning.

2. Future - 1985

Page 3, Lines 2-3 Notes that in the U.S. market, "car dealer share of total parts sales have historically and continually declined" from a 95% share held by U.S. car dealers in 1920 to "only 13%" in 1980.

Comment: If one accepts the figures for the declining car dealer share of total parts sales for domestic makers, one must note that of the 77% reported decline from 95% in 1920 to 13% in 1980, 65 of those percentage points of decline occurred before 1960. Or put another way, 85% of the total declin portrayed had occurred by 1960.

The next increment of decline from 30% in 1960 to 21% in 1972 represents 9% of the 77% decline, or about 11% of the total decline. The increment from 21% in 1972 to 18% in 1980, or three of the percentage points of decline represents 3.9% of the total decline.

Looking only at the last eight years experience, there has been a decline from 21% to 18%, or about 15%. And, from 1980 to 1985, about an 11% decline. Indeed, the rate of decline has been slowing significantly since 1960.

Lines 4-5 "This historical trend shows that Japanese car dealers will not be an exception."

Comment: Yet, their own figures show a decline from 50% in 1980 to 40% in 1985, a 20% rate of decline, more than double the 9% decline projected for the U.S., from 18% to 16%. Who really expects this to happen?

Lines 8-9 Repeats the claim that the Japanese dealers' share in the replacement parts market is "expected to decline."

Comment: While there may be a decline, it will be most unlikely to see the projected magnitude.

Lines 10-13 Claims: "And, this declining trend will be further exacerbated by the increased activity and participation of U.S. parts manufacturers and the independent distribution channel in the Japanese replacement parts market as well as increasing inflation and the change in consumer purchase patterns to D.I.Y. as a consequence of the cost consciousness of higher gasoline prices."

Comment: What is meant by this analysis? No evidence is offered to support the claim; none of it proves that U.S. parts makers will gain a larger share.

Lines 14-18 Repeats Management Perspectives Inc.'s premises that the independents' share will grow from 30% to 60%, while the dealers' share declines from 50% to 40%.

Comment: These premises are without substantiation.

Lines 18-20 The report draws the conclusion that "the sale of replacement parts outside the Japanese car dealer channel will double in the coming five years to 1985."

Comment: It is hard to accept this 100% increase in outside dealer sales, in light of the problems with the projected dealers' share decline. Also, even if the decline figures are accepted, the most important figure to look at is the rate of change for independents, a 20% gain between 1980 and 1985, a far cry from what the 100% increase portrays.

C. Sales Status of U.S. Independent Channel for Japanese Vehicle Replacement Parts (Exhibit 1-9)

Lines 23-25 Cites survey by Warehouse Distribution magazine, reporting 86.3% of warehouse distributors surveyed "handle car parts for import vehicles."

Comment: This fails to address the issue of Japanese car parts, clouding the issue by asking "do you stock replacement parts for import vehicles?"

To have any meaning, the figures would have to be broken down to show Japanese parts handled, and the magnitude of the Japanese lines they handle.

Lines 27-31 Cites reports by "94.6%" of warehouse distributors surveyed that they procure parts for import cars from U.S. parts manufacturers producing such import car parts. "This shows that U.S. parts manufacturers are actively participating in the market for import cars."

Comment: It shows nothing from which to draw such conclusions. What is meant by the figure? Is it one line of parts for Japanese cars, or is it only one item for Japanese cars? Does it, perhaps, mean VW, and no Japanese business? What is the magnitude of purchases of actual U.S. made parts for Japanese vehicles? None of this is portrayed.

No one can draw a valid conclusion from this "information" that U.S. parts makers are actively participati in the parts market for foreign imports, much less actively participating in the parts market for Japanese imports.

Exhibit 1-9, from which the 94.6% is drawn, also shows 26.2% of the respondents saying that they buy replacement parts for import cars from an importer (parts of foreign origin, bearing tradename of foreign manufacturer) or direct from foreign car manufacturers or agents outside U.S., which drew 4% response.

Comment: These two non-U.S. sources total to 30.2% of the respondents. It is impossible to tell the relative shares of purchases assigned to the two latter groups versus the weighted share of the 94.6% responding that they buy from U.S. manufacturers.

Lines 32-35 The report concludes "Further, from the fact that approximately 80% of the warehouse distributors reported that they consider import parts business profitable," and "they intend to and will be expanding their lines and coverage of replacement parts for Japanese vehicles in relation to the growth in U.I.O. and increasing vehicle age of Japanese vehicles."

Comment: JAMA draws this conclusion from the preceding faulty premise.

What buttressed these claims? What evidence is offered? Though no breakdown is given anywhere for Japanese units, all of these conclusions are

drawn for Japanese imports. Nowhere was the extent of coverage of Japanese vehicles mentioned, and it is impossible to make such glowing predictions for the future.

Section 3. Service Availability for Japanese Vehicle Parts (Exhibit 1-10)

A. Service Capabilities of Dealer Channel

Page 6, Line 1 Cites Exhibit 1-10, Comparing Japanese and U.S. car dealers.

Comment: While three sources are listed, including JAMA, it is not mentioned who specifically should get the credit for the information, and who supplied which information.

No mention is made of any overlap between domestic and Japanese dealers. It would be helpful to know the number of dealerships handling both domestic and Japanese makes.

Lines 3-4 "For Japanese vehicles in the U.S., as there are fewer dealers than for U.S. domestic make vehicles, the absolute number of service outlets is limited."

Comment: Certainly no comparative disadvantage may be drawn from this very relative statement.

Lines 5-12 "...both the U.I.O. per service bay and U.I.O. per mechanic for Japanese vehicles are lower than for domestic makes. This can be interpreted to mean that the Japanese dealer channel does not fall below that of U.S. domestic car dealers, and that the Japanese car dealer channel has the capability to offer vehicle owners an equivalent level of service."

Comment: Who has made this interpretation, on what grounds, and by what procedures?

Lines 13-16 Shows the parts fill rate of Japanese car distributors for four leading Japanese imports as very similar to U.S. auto makers supply rates.

Comment: The figures actually show just how actively the Japanese participate in their dealer channel.

B. Satisfaction of Japanese Car Owners in the U.S.

Lines 17-19 In the matter of satisfaction, the report notes "although various owner surveys are carried out, according to certain surveys of import cars, the following results have been noted."

Comment: What are the "various owner surveys (that) are carried out"? Why were these "certain surveys" results noted?

1. MEMA (Exhibit 1-11)

Lines 20-24 Cites MEMA owner survey, 1973. Of American small car owners surveyed, 76% felt American small cars are easier to get serviced, while 2.3% felt foreign small cars are easier to get serviced. Results shown in Exhibit 1-11.

Comment: This does not pertain to the Japanese vehicle issue. If "various owner surveys are carried out", why is this one chosen, which does not specifically mention Japanese vehicles?

Lines 25-26 JAMA qualifies the MEMA findings. "It must be noted that this survey was merely an expression of owner presumption and was not one of owner experience of difficulty in obtaining service."

Comment: So, it is a matter of owner presumption versus owner experience -- not much of a survey finding.

What cars did the respondents own, and how much can be construed as presumption versus experience? Surely, there must have been some owner experience if 76.8% could answer that American small cars were more easily serviced, as opposed to 2.8% who felt foreign small cars were more easily serviced.

2. TIME Marketing

Lines 27-30 Cites the satisfaction of 800 Datsun 200 SX owners surveyed.

Comment: Now JAMA shifts to a comparison with survey results of 800 Datsun 200 SX owners, a very specific pool versus the undefined pool above.

3. MONEY Magazine

Lines 31-36 Cites August, 1980 Money magazine report of survey results compiled by Mr. Peter Bohr. Bohr surveyed 25,000 vehicle owners.

Comment: No explanation is offered for who Peter Bohr is, and there is no exhibit showing the results.

No specific figures are advanced showing that "the owners of Toyota, Datsun, Honda vehicles expressed a higher level of satisfaction with their dealer service than surveyed owners of U.S. domestic small cars."

One would presume that JAMA is not calling this one "owner presumption."

Lines 35-36 Also noted, but do not show: "For the large majority of Japanese makes, parts were readily available."

Comment: What is meant by the "large majority?" For what share, "small minority", were parts not readily available? Why not carry the argument further; having said that owners were more satisfied with Japanese than domestic, how many felt parts were readily available for U.S. domestic small cars?

4. John C. Maloney & Associates, Inc. (Exhibit 1-12)

Page 5, Line 1 Cites Exhibit 1-12, Maloney study of 15,000 small car owners.

Comment: One drawback is that while it mentions Toyota, Datsun, Honda specifically, it does not list the "other imports" surveyed or the "competitive domestics" surveyed.

Lines 7-9 JAMA concludes: "Judging from these surveys, Japanese car owners are relatively satisfied with the service parts availability of Japanese car dealers which is comparable to the level of satisfaction of domestic U.S. makers."

Comment: JAMA draws its conclusion from some rather suspect survey material.

While JAMA notes the strong satisfaction, it brings into question the steep decline of 20% which they project for their dealers over the next five years, a rate of decline double the 9% they portray for U.S. dealers (Page 5, Line 17-18)

C. Service for Japanese Vehicles Outside the Dealer Channel (Survey results showed the following.)

1. Import Car magazine (Exhibit 1-13)

Lines 12-15 Using Exhibit 1-13, (Import Car survey of 1,750 service outlets for import cars), JAMA states in lines 14-15 that it "showed that almost all types of service for

import cars are being performed by such outlets."

Comment: None of this is pertinent to the discussion of Japanese imports. Exhibit 1-13 shows indeed, that in varying degrees of percentage shares, every type of service is performed by outlets on imports. It does not portray the percentage of respondents performing each type of service for Japanese imports.

Line 16-18 "In particular, over 90% of all outlets surveyed reported that they offered engine tune-up, brake, shock absorbers, engine hard parts and electrical repair service for import vehicles."

Comment: JAMA says "in particular", but this high rate is not broken down for Japanese vehicles, and is of no relevancy to the discussion.

Also, as noted, this percentage of respondents reported they "offered" services. Offering of course is very different than actually performing.

Lines 19-20 "Further, two-thirds of the outlets surveyed offered various types of service for Japanese vehicles."

Comment: JAMA finally gets down to some figures, but they are not statistically relevant. One does not know of the two-thirds that offered the service how much business each had for Japanese vehicles in each type of service.

2. Brake and Front End magazine (Exhibit 1-14)

Lines 21-25 Using Exhibit 1-14 (Brake and Front End 1979 survey), "84% of retail service outlets surveyed offered some type of service for import vehicles."

Comment: Again, this does not address the Japanese import issue. Nowhere is any empirical evidence presented regarding volume of Japanese import business at these outlets.

Line 24 Reports "imports accounted for 16.8% of overall sales."

Comment: Again, there is no breakdown for Japanese imports. Of the significant portion responding that they offered services, 16.8% of the overall sales were for imports. The recurring deficiency is the lack of a breakdown for Japanese imports.

3. Irving Cloud Publishing Co.

Lines 26-28 Cites the 1979 Irving Cloud Publishing Company survey findings that 39% of all jobbers surveyed handle parts for import vehicles, and more than 30% maintain a

machine shop for necessary import car services.

Comment: It says nothing about the degree to which jobbers handle parts for Japanese vehicles or perform machine shop services for Japanese imports. Again, it is vastly different to offer services than to actually perform services for Japanese imports.

There is no exhibition of these survey results.

4. A.T. Kearney Inc.

Lines 30-31 Cites A.T. Kearney, Inc. findings that "80% to 90% of warehouse distributors and jobbers surveyed handle replacement parts for Japanese vehicles."

Comment: Although A.T. Kearney Inc. is JAMA's contractor, the nebulous "80% to 90%" results are not exhibited.

There is no adequate description of the population surveyed.

Lines 32-34 Notes the majority had a limited line of parts for Japanese vehicles.

Comment: What specifically is the "majority?" What is meant by "limited line"?

These nebulous figures contrast sharply with the glowing report made on Page 5, Line 23-27. Of the warehouse distributors surveyed, 86.3% reported that they handle parts for import vehicles, a sharp increase in comparison with the status in 1973, when the survey showed that 65.5% of the warehouse distributors handled import parts.

Taking the two together, the real conclusion might be stated: while many more warehouse distributors handle import parts in 1980 than did in 1973, their handling of Japanese parts is very limited. So, what happened to all the growth?

Page 8, Line 1-2 "Further, in 1980 5% to 10% of the warehouse distributors, jobbers were handling a full line of replacement parts for Japanese vehicles."

Comment: Indeed, the majority had a limited line. While it does not say it, this means A.T. Kearney found that 90%-95% of warehouse distributors and jobbers had no full line, but degrees of limited lines. How "limited", cannot be discened from this vague report.

Page 8, Lines 2-3 JAMA concludes: "By 1985, this (percentage handling full Japanese line) is estimated to increase to 20% to 30% of all warehouse distributors and jobbers."

Comment: JAMA draws its conclusion from the preceding shaky figures. Who estimates this increase, and on what statistical basis?

The estimated increase is especially suspect in light of the wide gap between the growth rate in warehouse distributors handling import lines and the small number that now handle a full Japanese line.

Lines 4-7 JAMA draws the conclusion: "Thus, from the above, it can be concluded that even outside the dealer channel, service for Japanese vehicles is available to a wide extent and that owners of Japanese vehicles can obtain an equitable level of service for their vehicles."

Comment: JAMA's information, if anything, truly shows how very improbable it would be for U.S. independent channels to pick up a 20% share in the market to compensate for the wildly improbable projections for a 20% decline in their dealers' share.

Comment on Chapter I: The entire chapter flies in the face of Japan's own stated commitment in the Trade Facilitation Committee (TFC) process. According to a Commerce Department source, the Japanese have promised to take some steps to open up their dealerships. This report contradicts those intentions, insisting that the Japanese need not do anything. According to the report's Introduction, it indicates "the direction that we feel should be taken to result in increased participation by U.S. manufacturers in the U.S. replacement parts market for Japanese vehicles." (Page 2, Lines 17-18)

CHAPTER III. ADOPTION OF U.S.-MADE AUTOMOTIVE PRODUCTS
-present and future-

Section 1. U.S.-made Automotive Products Handled by Japanese Car Distributors

Page 26, Lines 1-5 Reports that "each Japanese auto maker has continued to adopt U.S.-made automotive products for the U.S. market as produced by the U.S. automotive manufacturers to the greatest degree possible with full efforts to promote and sell such automotive products through their Japanese car dealers in the U.S."

Comment: What is meant by the "greatest degree possible" and the term "full efforts to promote and sell such automotive products through their ...dealers in the U.S."? No evidence for these claims is offered.

Lines 6-7 "And, at present, each Japanese auto maker is handling a large volume of U.S.-made automotive products."

Line 8 To buttress the claim in Lines 6-7, JAMA introduces its own compiled statistics. (Exhibit 3-1)

Comment: Exhibit 3-1 is entitled "Japanese Car Distributors' Purchase of U.S.-made Automotive Products." It is noteworthy that the report now speaks of automotive products of U.S. manufacturers rather than parts. What is the significance of this change of terminology?

It is also significant that while the title of the exhibit uses the term U.S.-made automotive products, in the text discussing the exhibit, (lines 8-11), JAMA notes that "in 1979, Japanese auto makers exported $350 million worth of REPLACEMENT PARTS to the U.S. And, their purchases of U.S.-made AUTOMOTIVE PRODUCTS amounted to $150 million in the same year." (emphasis added)

Exhibit 3-1 does not show a figure for "each Japanese auto maker," even though JAMA is the source cited. The chart shows a phenomenal growth in Japanese export shipment of replacement parts from 1977 to 1978. Sales increased 40.3% from $248,034,000 in 1977 to $347,996,000 in 1978. During the same period, JAMA reports that Japanese distributors increased purchases of U.S.-made automotive products from $80,359,000 in 1977 to $85,315,000 in 1978, a change of approximately 6.2%.

Then, one is expected to believe that after a period of 40.3% growth in replacement parts exports, the Japanese actually decreased their parts exports from the 1979 figure of $347,996,000 to $347,283,000 (1979). Thus, after a period of rapid growth, the Japanese follow

with a decline. But in their same period of decline, it is alleged that purchases of U.S.-made automotive products grew at a rate of about 78%. Only the year before, it had grown at 6.2%. To what is this due?

Lines 11-14 JAMA claims that the "rate of local purchases of U.S.-made automotive products (100) as compared to the export value of replacement parts comes to 43.4% points, a very high rate."

Comment: This growth is from a very small base, which is not mentioned. The important comparison to be made in Exhibit 3-1 is the percentage shares. When comparing, the Japanese have 70% and the U.S., 30%. So much for "very high" rates.

Lines 14-16 "This trend can be interpreted and forecasts that each Japanese auto maker will be making efforts hereafter in accordance with the growth of the Japanese vehicle market in the U.S."

Comment: It is never explained how this trend is interpreted. Should it be interpreted to mean that Japanese shipment of replacement parts to the U.S. will continue to decline? Is that the trend of the future?

It does not show anywhere who is forecasting or how a forecast is made for "each Japanese auto maker" to make "further efforts hereafter in accordance with the growth of the Japanese vehicle market in the U.S."

Section 2. U.S. Parts Manufacturers' Participation in the Replacement Parts Market for Japanese Vehicles

A. Status of U.S. Parts Manufacturers' Participation

Lines 20-23 "As previously stated in Section 1 of Chapter 1, approximately 50% of the total market of $1.06 billion for Japanese replacement parts is sold outside the dealer channel in the U.S. Thus it can be noted that many U.S. manufacturers are actively participating in this market."

Comment: How is this conclusion reached that if 50% is outside the dealer channel, it can be noted that many U.S. manufacturers are active in the market?

Does the term "many U.S. manufacturers" refer to manufacturing of automotive products or replacement parts? The discussion has changed back to replacement parts.

Lines 24-27 Cites Warehouse Distribution survey, Exhibit 3-2, that 88% of U.S. parts manufacturers "have increased the number of items for import cars." The population studied here is the U.S. parts manufacturers manufacturing/selling import car parts.

Comment: What is the difference between manufacturers manufacturing import car parts versus those that manufacture and sell import car parts? For example, a manufacturer may only manufacture one item for imports but may sell many lines of parts made overseas.

They were asked if they "have increased or decreased the number of import car items in your lines during the years you have been offering them?" Nowhere is this discussed or broken down to show plans for increasing Japanese items or an actual increase in items for Japanese cars.

Exhibit 3-2 also shows manufacturers response to the question: "Approximately what percent of your total dollar volume of import car parts is represented by the following makes?" Toyota, Datsun, Honda, Subaru, and Mazda totaled to 61.1%.

This offers no gauge of success. What needs to be shown is the percentage of total dollar volume of all parts represented by each Japanese make. While 3-2 shows 88% planning an increase in their import item lines, Exhibit 3-7 shows that of the same pool of respondents, 68% include in their future plans "wide coverage for top makes of imports."

Again, none of this addresses the Japanese import issue. The 88% planning a line increase times the 68% planning "wide coverage" total to only 60% of the respondents planning wide coverage for imports.

Figures cited in Chapter I do not support Chapter III contentions of active U.S. manufacturers participation in the Japanese aftermarket. In fact, the "givens" in Chapter I were: 1) 86.3% of warehouse distributors handle parts for imports (no breakdown for Japanese), up from 65.5% in 1973; (2) and 94.6% of warehouse distributors procure parts for import cars (no specifics on Japanese) from U.S. parts manufacturers producing such import car parts; STILL (3) only 5-10% of warehouse distributors had a full line of Japanese items and the vast majority had extremely limited lines.

Lines 27-30 Report cites Exhibit 3-3, which shows "at a glance" the "import car parts items handled by each of the 250 U.S. parts makers/suppliers."

Comment: This in no way addresses items for Japanese cars, nor is any evidence provided for the percentage share of business represented by items in a line.

Lines 31-35 Report cites Exhibit 3-4. It presents a list of 22 U.S. parts makers and is entitled "Survey of U.S. Parts Makers Producing, Procuring Japanese Car Parts."

Comment: Exhibit 3-4 is fraught with problems. The descriptions of coverage range from "% coverage" to "all popular imports," "most popular Japanese and VW," and "Japanese and VW." What are "all popular imports"? How does this differ from "most popular Japanese and VW"? Of this, how much is for "most popular Japanese" versus "most popular VW"?

Terms are used such as "all major imports," "most major imports," and "most imports." How does "all major imports" differ from "most major imports"? How does "most imports" vary from the above two?

Another classification is "all top lines." What does that mean? No explanation is given for the term "Datsun Only-Expanding." The same criticism applies to the "major import--70% coverage term. Also listed is "Toyota, Datsun and VW only," but no mention is made of the relative shares held by each.

Only in seven cases were the parts 100% U.S.-made, with others listing varying degrees of procurement from abroad. Since comparisons are impossible, the results have no value, and the number studied is insignificant.

B. U.S. Production of Replacement Parts for Japanese Vehicles

Page 27, Lines 2-4 Cites Exhibit 3-5 survey results that "66% of all manufacturers surveyed are producing parts for import vehicles.

Comment: This does not address the Japanese aftermarket issue.

This paper's previous analysis showed that even if 66% manufacture any type of replacement parts for imports, very few have anything but limited lines for Japanese imports. (Nowhere of course, is any of this related to U.S. difficulty in entering the Japanese original equipment (O.E.) market.)

Furthermore, if one takes the 88% of so-called U.S. parts manufacturers manufacturing/selling parts for imports who plan to increase their lines (not specifical Japanese) times the 66.2% who make any type of import parts, one finds that only 58% of U.S. parts manufacturers make parts for imports and plan to expand their product lines. This means that about 42% of all U.S. parts manufacturers either make no such parts or do not plan to increase lines if they do make them.

Lines 5-8 Cites Exhibit 3-6, entitled "The Status of Japanese Car Parts Production by U.S. Parts Makers." The source of the survey is JAMA contractors A.T. Kearney and Management Perspectives, Inc.

Comment: In Part I, eight examples are given of U.S. makers "producing almost all applications of replacement parts for Japanese vehicles."

What is meant by almost all applications? For which makes and models? For one make and model, or two or three? Also, no value is stated anywhere for the volume of Japanese purchases compared to domestic sales.

In Part II, five examples are given of U.S. makers producing limited items. What in the world does "limited" mean? Nowhere is spelled out how many makes, models, or percentage of total sales involved. Just because they make it does not assure that the Japanese are buying any appreciable amount.

The 13 examples given are such a small number that the findings have no statistical value. What is needed is a random sample; a scientific study.

Lines 9-12 The report cites "Small Japanese U.I.O. and the rather young age of the U.I.O." as the reasons why the "current situation with overseas affiliate companies or by importing is sufficient."

Comment: The two reasons cited are specious. This, finally, is JAMA's admission, and after all of its report's strivings to show how actively U.S. manufacturers are participating in the Japanese replacement market.

C. Outlook

Lines 25-26 The report confuses a 95% figure found in Exhibit 1-9.

Comment: Exhibit 1-9, which this paper disputed, showed that 95% of warehouse distributors selling import car parts purchase replacement parts "from U.S. manufacturers who also make import car parts." This has absolutely nothing to do with the claim that "95% of the import car parts handled by warehouse distributor are purchased from U.S. parts manufacturers."

Lines 27-29 JAMA draws the conclusion that warehouse distributors "will certainly be a major pressure and influence on U.S. parts manufacturers to expand their import car parts line and production facilities."

Comment: While this conclusion bears some truth, it is essential that there first be more open dealerships and meaningful access to the Japanese O.E. market.

Page 28, Lines 1-3 Notes that increasing trend to small car production in the U.S. will "place greater emphasis on production technology and facilities for small car parts."

Comment: There will never be any meaningful trend without a better U.S. share in the Japanese O.E. market.

Lines 3-6 "As the market participation of U.S. parts manufacturers accelerate added to the initiation of vehicle production in the U.S. by Japanese auto makers, it needs no explanation that the production of parts for Japanese vehicles will develop drumatically."

Comment: This statement requires a great deal of explanation for the anticipated dramatic effects. This is based on the questionable premise of accelerated U.S. participation.

It leaves out an important condition, that of future Japanese parts production in the U.S., tied to "vehicle production in the U.S. by Japanese auto makers."

Lines 5-6 The report concludes that "production of parts for Japanese vehicles will develop dramatically."

Comment: It is noteworthy that JAMA chose the phrase "production of parts" rather than saying "U.S. production of parts" for Japanese vehicles will develop dramatically.

Lines 7-10 The report concludes: "Although a portion of the replacement items (for Japanese cars) may not be feasible for production by U.S. parts makers in terms of economic lot production, it can definitely be said, that in general, the opportunity for U.S. parts makers in the replacement parts market for Japanese vehicles will increase more and more."

Comment: The conclusion is a classic understatement. It makes no note, of course, of O.E. market entry and dealer impediments to production of more than just a portion of replacement items.

The second part of the conclusion is rather nonsensical but optimistic. It states "in general" there will be increasing opportunities, but as throughout the report, one never learns the specifics. A general conclusion drawn from many generalities.

APPENDIX G

A BILL

To amend the Tariff Schedules of the United States to create a passenger automobile and automobile truck part and accessory duty remission item classification. Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. FINDINGS; PURPOSE.

(a) FINDINGS. - The Congress finds that -

(1) in recent years the United States has been inundated with importations of foreign-built passenger automobiles and automobile trucks,

(2) these importations have been stimulated in large part by the low duty rates imposed on passenger automobiles by the United States,

(3) as a result of the large volume of importations of foreign-built passenger automobiles and automobile trucks, the United States automotive industry has suffered immeasurable economic injury,

(4) the economic injury which has occurred has not been limited to the domestic automotive industry but has also been felt by domestic suppliers of automotive parts and accessories,

(5) unusual and immediate measures are required to reverse the economic injury to the United States automotive industry and to prevent further injury.

(b) PURPOSE. - It is the purpose of this Act to provide an incentive for motor vehicle manufacturers in foreign countries to purchase United States automotive components by establishing a passenger automobile and automobile truck part and accessory duty remission item classification under the Tariff Schedules of the United States which would allow for the remission of duties on imported passenger automobiles and automobile trucks under certain circumstances.

SECTION 2. MOTOR VEHICLE PART AND ACCESSORY REMISSION CLASSIFICATION.

(a) IN GENERAL. - Subpart B of Part 1 of Schedule 8 of the Tariff Schedules of the United States (19 United States Code § 1202) is amended by inserting the following new item:

ITEM 807.50

"Motor vehicles classified under Item 692.10 and Item 692.02 of the Tariff Schedules, manufactured in a foreign country which have installed thereon parts and accessories produced in the United States which (a) were exported in condition ready for assembly without further fabrication, (b) have not lost their physical identity in such articles by change in form, shape or otherwise, and (c) have not been advanced in value or improved in condition abroad except by being assembled and except by operations incidental to the assembly process such as cleaning, lubricating, and painting. Providing that such United States origin parts and accessories have been exported from the United States, the imported motor vehicles may contain motor vehicle parts and accessories equivalent to and in lieu or the United States motor vehicle parts and accessories exported from the United States."

(b) DUTY RATE. - The duty ascribed to Item 807.50 shall be as follows:

"A duty upon the full value of the imported motor vehicle, which duty is reduced by the cost or value of such products of the United States, even though products in lieu thereof may have been installed on the motor vehicle. (See headnote 3 of this subpart.)"

SECTION 3. HEADNOTE REVISION.

(a) IN GENERAL. - Headnote 3 of Subpart B of Part 1 of Schedule 8 of the Tariff Schedules of the United States (19 United States Code § 1202) is amended by altering the title of the headnote from "Articles assembled abroad with components produced in the United States" to "Articles assembled abroad with components produced in the United States or components in lieu thereof."

(b) INCLUSION OF ITEM 807.50. - Headnote 3 shall be amended to apply to Item 807.50 as well as Item 807.00.

(c) REVISION OF HEADNOTE 3(b). - Headnote 3(b) is amended by redesignating such headnote as 3(c) and by amending the first sentence by inserting at the beginning thereof the clause -- "For purposes of Item 807.00."

(d) HEADNOTE 3(b) REPLACEMENT. - Subpart B Headnotes of Part 1 of Schedule 8 of the Tariff Schedules is amended by inserting the following new Headnote 3(b).

"For purposes of Item 807.50, the value of the products in lieu of products of the United States assembled into the imported articles shall be deemed the same as the value of products of the United States as referenced in the above sections (a), (i) and (ii)."

(e) HEADNOTE 3(d). - Subpart B Headnotes of Part 1 of Schedule 8 of the Tariff Schedules is amended by inserting the following new Headnote 3(d).

"For purposes of Item 807.50, the duty on the imported article shall be at the rate which would apply to the imported article itself, as an entirety without constructive separation of its components, in its condition as imported if it were not within the purview of this subpart. If the imported article is subject to a specific or compound rate of duty, the total duties shall be reduced by an amount equal to the cost or value of such products of the United States installed on the imported article. Should products in lieu of products of the United States be installed on the imported article their cost or value shall be deemed the same as the cost or value of the products of the United States for which they are substituted. Under no circumstances will a credit be granted for the value of products in excess of the duty due."

(f) HEADNOTE 3(e). - Subpart B Headnotes of Part 1 of Schedule 8 of the Tariff Schedules is amended by inserting the following new Headnote 3(e).

"For purposes of Item 807.50, all parties who meet the general requirements and applicable regulations of Item 807.50 shall receive the duty treatment specified therein during 1983. Thereafter, any party requesting Item 807.50 treatment during any given year must for the immediate prior year (first base year) meet the following criteria:

The requesting party's percentage, as calculated in United States dollars, of its purchases of United States origin passenger

automobile and/or automobile truck parts and accessories to its exports of passenger automobiles and/or automobile trucks to the United States must either increase or remain constant over the previous year (second base year).

In the event there is any decrease in dollar volume of purchases of United States origin parts and accessories in any given year by the requesting party, such party will be ineligible to receive Item 807.50 treatment for the immediate subsequent year. This ineligibility shall apply even though there may have existed a corresponding or greater decrease in exports of passenger automobiles and/or automobile trucks to the United States resulting in an overall percentage increase or percentage constant in purchases of United States origin parts and accessories to exports of passenger automobiles and/or automobile trucks to the United States.

Once a decrease in dollar volume of purchases of United States origin parts and accessories has occurred, the requesting party will again be eligible to receive Item 807.50 treatment once the previous high in dollar volume of purchases of United States origin parts and accessories has been reached or surpassed. For purposes of such calculations, the previous high in purchases of United States origin parts and accessories shall remain the base figure until it has been surpassed. The base figure for exports shall be the actual figure for the base year in use."

SECTION 4. AUTHORITY TO PROMULGATE REGULATIONS.

The Secretary of the Treasury is expressly authorized to promulgate and implement regulations for the regulation of the foregoing legislation.

SECTION 5. EFFECTIVE DATE.

The amendments made by Sections 2(a) and (b), Sections 3(a), (b), (c), (d), (e) and (f) and Section 4 shall apply with respect to articles entered or withdrawn from warehouse for consumption on or after January 1, 1983.

SECTION 6. STUDY TO DETERMINE WAYS TO INCREASE THE USE OF AMERICAN-MADE NEW AND REPLACEMENT PARTS BY FOREIGN MANUFACTURERS AND OF DISCRIMINATORY PRACTICES AFFECTING DOMESTIC PRODUCTION OF MOTOR VEHICLE PARTS

Within one year after the date of the enactment of this act, the Secretary of Commerce shall undertake an investigation and submit to Congress a written report determining how to increase the use of American-made new and replacement motor vehicle parts by foreign manufacturers. The investigation and report shall also encompass the policies and practices that are used by vehicle manufacturers to cause United States motor vehicle dealers to choose foreign-made replacement parts for motor vehicles rather than domestically produced parts. Such report shall include but not be limited to recommended administrative or legislative action that the Secretary considers appropriate to increase the use of American-made new and replacement motor vehicle parts by foreign manufacturers and to assure that domestic producers of replacement parts are accorded fair access to the United States market for such parts.

APPENDIX H

PROPOSED LEGISLATION TO GRANT RELIEF TO THE UNITED STATES AUTOMOTIVE INDUSTRY BY CREATING AN INCENTIVE FOR VEHICLE MANUFACTURERS IN FOREIGN COUNTRIES TO PURCHASE UNITED STATES ORIGIN AUTOMOTIVE COMPONENTS

A. Introduction And Proposal Outline

Foreign-made passenger automobiles and automobile trucks have inundated United States' markets in recent years. Our low duty rates on these items in large part stimulated the imports. Schedule 6 of the Tariff Schedules of the United States sets no quota restrictions and assesses a low duty rate of 2.8% ad valorem on passenger automobiles. Foreign vehicle manufacturers place great weight on our low duty rates, evidenced by the negative reaction to a reclassification raising the duty on automobile truck cab and chassis from 4% ad valorem to 25% ad valorem. Our duty rates contrast starkly with those of our major trading partners, such as France, Italy, Germany, The United Kingdom and Canada which impose duty rates on automobiles as high as 14% ad valorem. Many of these nations also restrict the number of vehicle imports.

The flood of foreign-built passenger automobile and automobile truck imports has caused the United States automotive industry immeasurable economic harm. The injury has devastating effects that reach well beyond vehicle manufacturers to the thousands of original equipment and replacement parts suppliers. The damage is rending the entire United States economy. The injury must not develop into a chronic condition. We must take extradordinary and immediate steps to halt that deterioration.

Our plan offers foreign vehicle manufacturers the incentive to save hundreds of millions of dollars by purchasing United States made automotive products. The plan would create a new passenger automobile and automobile truck component duty remission item classification under the Tariff Schedules of the United States. This is a novel approach to the duty remission provisions now in the law. The current duty remission provisions permit the value of United States made parts to be deducted from the value of the vehicles upon which they enter the United States, before the duty is applied.

The effective duty reductions have afforded little incentive for purchasing products made in the United States and, since the parts must return on vehicle imports to this country, the current provision foregoes the prospect of installing United States made products on vehicle shipments to third markets. Our plan addresses both limitations. First, it provides a credit that could reduce the amount of duty on a vehicle import one dollar for every dollar of United States product which the manufacturer purchases. While current law cuts the amount to be taxed, our plan cuts the tax itself. Second, our plan opens the door to valuable aftermarket sales opportunities worldwide, since installing United States origin parts on vehicles bound for other countries does not jeopardize the credit.

The first stage in the voluntary plan is for the vehicle manufacturers in a foreign country to purchase United States origin parts and accessories. The Secretary of the

Treasury will prescribe regulations to monitor the purchase orders and exports.

In the second stage, when the vehicle manufacturer exports to the United States, Customs officials will calculate the amount of duty on the full value of the automobiles and automobile trucks at the rate of 2.8% ad valorem and 25% ad valorem, respectively. The duty then will be reduced by an amount equal to the cost or value of United States origin parts and accessories purchased if either such parts and accessories or equivalent parts and accessories are installed on the motor vehicle.

Vehicle manufacturers in foreign countries who participate in the voluntary program will pay effective duty rates well below 2.8% ad valorem and 25% ad valorem. In fact, there is incentive for them to purchase enough United States products to land their vehicles in the United States duty free. However, under no circumstances will a credit for the value of parts be granted in excess of the duty otherwise due.

The proposed program would be available to all foreign-based motor vehicles manufacturers during its first year of operation. Thereafter, the program would only be available to foreign-based motor vehicle manufacturers who for the prior year maintained or increased the percentage as calculated in United States dollars, of their purchases of United States origin automotive parts and accessories to their exports of motor vehicles to the United States. In the event there was a decrease in dollar volume of purchases of United States origin parts and

accessories in any given year, the foreign-based manufacturer would be ineligible to receive the duty credits for the immediate subsequent year. This ineligibility would apply even though there may have existed a corresponding or greater decrease in exports resulting in an overall percentage increase or percentage constant in purchases of United States origin automotive parts and accessories to exports of motor vehicles to the United States. Once a decrease in dollar volume of purchases of United States origin parts and accessories has occurred, the foreign-based manufacturer would again be eligible to participate in the program once the previous high in purchases of United States origin parts and accessories has been reached or surpassed.

The program will be totally voluntary and the Secretary of the Treasury will prescribe regulations for its implementation and functioning.

B. Section Analysis of Proposed Legislation

Section 1 of the proposed legislation outlines the findings of Congress and purposes of the Act.

Section 2 of the proposed legislation provides for a new item classification in the Tariff Schedules of the United States. This item classification could effectively lower the duty rates provided by the Tariff Schedules. It reduces the amount of duty due by an amount equal to the value of the United States origin parts and accessories which the vehicle manufacturer purchases and may install on motor vehicles.

The new item classification imposes a duty upon the full value of the passenger automobile or automobile truck. That duty is then reduced dollar for dollar by the cost or value of United States products purchased, even though the manufacturer may install non-United States made equivalent products on its exports to the United States. However, a credit will not be granted for the value of purchases of United States origin products in excess of the actual duty due.

Section 3 of the proposed legislation makes the necessary amendments to the applicable headnotes in order that the value and cost of the United States parts and accessories or parts and accessories in lieu thereof can be determined for duty purposes. It further provides that after the initial year of the program, eligibility for the program will be directly linked to the dollar volume of automotive parts and accessories purchases as they relate to the volume of motor vehicle imports. Once the amendments are enacted, the revised headnotes will read as follows:

> 3. Articles assembled abroad with components produced in the United States or components in lieu thereof. -- The following provisions apply only to Items 807.00 and 807.50.
>
> (a) The value of the products of the United States assembled into the imported article shall be --
>
> (i)the cost of such products at the time of the last purchase; or
>
> (ii)if no charge is made, the value of such products at the time of the shipment for exportation,
>
> as set out in the invoice and entry papers; except that, if the appraiser concludes that the amount so set out does not represent

a reasonable cost or value, then the value of such products shall be determined in accordance with section 402 of this Act.

(b) For purposes of Item 807.50, the value of the products in lieu of products of the United States assembled into the imported article shall be deemed the same as the value of products of the United States as referenced in the above sections (a), (i) and (ii).

(c) For purposes of Item 807.00, the duty on the imported article shall be at the rate which would apply to the imported article itself, as an entirety without constructive separation of its components, in its condition as imported if it were not within the purview of this subpart. If the imported article is subject to a specific or compound rate of duty, the total duties shall be reduced in such proportion as the cost or value of such products of the United States bears to the full value of the imported article.

(d) For purposes of Item 807.50, the duty on the imported article shall be at the rate which would apply to the imported article itself, as an entirety without constructive separation of its components, in its condition as imported if it were not within the purview of this subpart. If the imported article is subject to a specific or compound rate of duty, the total duties shall be reduced by an amount equal to the cost or value of such products of the United States installed on the imported article. Should products in lieu of products of the United States be installed on the imported article their cost or value shall be deemed the same as the cost or value of the products of the United States for which they are substituted. Under no circumstances will a credit be granted for the value of products in excess of the duty due.

(e) For purposes of Item 807.50, all parties who meet the general requirements and applicable regulations of Item 807.50 shall receive the duty treatment specified therein during 1983. Thereafter, any party requesting Item 807.50 treatment during any given year must for the immediate prior year (first base year) meet the following criteria:

> The requesting party's percentage, as calculated in United States dollars, of its purchases of United States origin passenger automobile and/or automobile truck parts and accessories to its exports of passenger automobiles and/or automobile trucks to the United States must either increase or remain constant over the previous year (second base year).

In the event there is any decrease in dollar volume of purchases of United States origin parts and accessories in any given year by the requesting party, such party will be ineligible

to receive Item 807.50 treatment for the immediate subsequent year. This ineligibility shall apply even though there may have existed a corresponding or greater decrease in exports of passenger automobiles and/or automobile trucks to the United States resulting in an overall percentage increase or percentage constant in purchases of United States origin parts and accessories to exports of passenger automobiles and/or automobile trucks to the United States.

Once a decrease in dollar volume of purchases of United States origin parts and accessories has occurred, the requesting party will again be eligible to receive Item 807.50 treatment once the previous high in dollar volume of purchases of United States origin parts and accessories has been reached or surpassed. For purposes of such calculations, the previous high in purchases of United States origin parts and accessories shall remain the base figure until it has been surpassed. The base figure for exports shall be the actual figure for the base year in use.

Section 4 of the proposed legislation authorizes the Secretary of the Treasury to promulgate and implement regulations for the regulation of the program.

Section 5 or the proposed legislation establishes the effective date of the Act to be January 1, 1983.

Section 6 of the proposed legislation directs the Secretary of Commerce to undertake a study to determine ways to increase the use of American-made new and replacement motor vehicle parts by foreign manufacturers. The study is also to encompass the policies and practices that are used by vehicle manufacturers to cause United States motor vehicle dealers to choose foreign-made replacement parts for motor vehicles rather than domestically produced parts. A report of the study is to be submitted to Congress within one year of the date of enactment of the Act. It is to contain recommended administrative and legislative action to increase the use of American-made new and replacement motor vehicle parts by foreign manufacturers and to assure that domestic producers of replacement parts are accorded fair access to the United States market for such parts.

Senator DANFORTH. Mr. McElwaine.

STATEMENT OF ROBERT M. McELWAINE, PRESIDENT, AMERICAN INTERNATIONAL AUTOMOBILE DEALERS ASSOCIATION, WASHINGTON, DC

Mr. MCELWAINE. Mr. Chairman, Senator Matsunaga, I perceive that the intent of your hearing, Mr. Chairman, has been to find answers to several questions that are of great importance to, obviously, the 10 million Americans who buy new cars every year, the 1.4 million or so people who are engaged in the industry itself, as well as to, really, the entire economy, across the board. These three questions, essentially, are:

First, how will the U.S. industry fare when quotas end as scheduled on April 1, 1985?

Second, what effect have the quotas had over the 3½ years they have been in effect on the pricing of U.S. automobiles, on employment in the U.S. industry, and on the consumer?

Third, is it really true that U.S. companies are operating on a tilted playing field at a competitive disadvantage with their Japanese competitors?

Now, our answers to these questions are in our written testimony. I will try to touch briefly on those answers in the time we have, and I appreciate the chairman and Senator Matsunaga staying with us to hear this.

We have heard the kind of Malthusian forecasts so far this morning as to what will happen to the U.S. automobile market with an end to quotas, including projections that the Japanese will take over 40 to 42 percent of the U.S. market. All of these projections completely ignore the capacity that the automobile industry in this country has right now to reduce prices. They are making more profits per vehicle than they ever have in their entire history. General Motors' net profit per car after taxes now exceeds $1,000 a car—more than double what it had been in most years in their history.

Obviously, the domestic producers have the opportunity and the capacity in the face of renewed price competition to slash their prices drastically, perhaps by as much as 10 percent. A 10-percent cut in automobile prices would give us an automobile market in this country of 12.5 to 13 million cars a year. Now, under such circumstances, even if the Japanese were able to increase their sales by half a million units, their market share wouldn't grow at all.

Ward's Auto World, a publication that is really the bible of the domestic industry, says that Japanese manufacturers would not achieve U.S. sales in excess of 2.6 million units even in the absence of any restraints and without any price cuts. In a 12.5 million car market, this represents a market share of about 20 percent, or just about what they have now. So these projections of a 40- to 42-percent share of market are really sort of "sky is falling" projections.

The effect of quotas on U.S. car prices has been discussed. You have heard it said here that U.S. car prices have only increased by 2 percent a year since the imposition of quotas. I can only quote the respected economic writer Robert Samuelson, who says that

"auto executives, in making such statements," and I quote from Mr. Samuelson, "are using government statistics either incompetently or dishonestly." The Wharton Institute says the selling prices of cars has increased since April 1981, at a rate nearly double that of the Consumer Price Index. If there is any question remaining that quotas have brought about higher car prices, this certainly should have been dispelled by the profit performance of the Detroit automakers.

The Wall Street Journal says, "The gross profit per car after break even today is reaching $3,000 a car in Detroit."

We should also compare this performance with the Japanese companies. We hear about the great profits being made by the Japanese companies, and how this gives them funds that they can use to invest in new production techniques; yet the fact is that according to last year's reports General Motors made $912 net profit after taxes on each car they sold, and Toyota made $265. Now, who is making all this money? It seems to me that the big funds are being built up by the domestic manufacturers, not the Japanese.

And of course Ambassador Brock gave us the figures as to what it costs the working man, since quotas went into effect, to buy a car. In 1980 the average working man in the United States could buy a new car with the proceeds from 32 weeks of labor. Today it requires 38 weeks of his salary, or a 19-percent increase.

Mr. Chairman, if I could just touch on one other subject before I stop, because I think it is so important, and this is the effect that these quotas have had on the overall economy up and down the line.

What we have seen since the quotas went into effect is an escalation in used-car prices from an average used-car price of $3,000 to more than $5,000. We have seen the annual expenses for automotive repairs go up by $13 billion a year, and we have seen people frozen out of the new-car market.

This trend that you spoke about, Mr. Chairman, of the trend toward buying bigger, more expensive cars, is merely representative of the fact that the small car buyer, the economy car buyer, is frozen out of the market. There is no product available for him.

General Motors introduced the Suzuki out on the west coast, a car selling at less than $5,000, and it is the most successful new-car introduction since the Ford Thunderbird in 1955. That shows you what market is out there. And if we bring our prices down, we'll have a 13 million car market, we'll put 100,000 workers back to work, and we'll create an economic revival in the heartland of this country like we have never seen before.

Thank you, sir.

Senator DANFORTH. Thank you, sir.

[Mr. McElwaine's prepared statement follows:]

Prepared Statement of Robert M. McElwaine on Behalf of the American International Automobile Dealers Association

SUMMARY OF TESTIMONY

Given Detroit's profitable position, there is no reason to continue to saddle the U.S. consumer with the burden of higher prices resulting from the quota limits on Japanese cars. Objective and independent studies have estimated that the quotas are responsible for price increases ranging from $400 to $1000 per car.

Fears that an end to quotas will mean a takeover of the American market by Japanese automakers are groundless. A research report made by Ward's Auto World, one of the auto industry's most respected trade journals, says that, in a free market, Japanese manufacturers could not increase their market share by more than three or four percentage points.

Lower automobile prices, as a consequence of a free market, could create an expanded U.S. automobile market of 12.5 to 13 million new cars annually. Even if they could increase sales by 500.000 units, in such a larger market, Japanese manufacturers would not materially increase their market share. The economic benefits from such an expanded auto market could create an industrial revival across the entire heartland of America.

Claims of a "tilted playing field" favoring Japanese auto sales in the U.S. are distorted and groundless. Any cost advantage accruing to the Japanese automakers as a consequence of the overvalued dollar probably do not exceed the total of additional transportation and duty costs their cars must bear. Rather than enjoying a tax advantage over American cars, Japanese cars actually bear a higher tax burden.

Given their present level of profits, U.S. auto manufacturers have the capacity to reduce prices substantially. The greater volume resulting from lower prices would mean a continuing high

level of profitability. Continuance of the present low-volume, high-profit policy acts against the best interests of the consumer, keeping employment in the auto industry at low levels and preventing millions of Americans who want and need a new car from making such a purchase.

The supposed cost advantage enjoyed by Japanese auto manufacturers over the U.S. competitors has been vastly exaggerated and inaccurately analyzed. Japanese profits per new vehicle retailed are a fraction of those enjoyed by U.S. manufacturers. Detroit is perfectly capable of competing with imports today in a free and unrestricted market.

This hearing is designed to find answers to questions that are fundamental to the future of the United States automobile industry - and, indeed, to the future of the American economy.

Those questions are:

-HOW WILL THE U.S. AUTO INDUSTRY FARE UNDER FREE-MARKET COMPETITION, WITHOUT THE PROTECTION FROM IMPORTS GRANTED IT BY THE FEDERAL GOVERNMENT?

-WHAT EFFECT HAVE THE QUOTAS ON JAPANESE AUTO IMPORTS HAD ON CONSUMER PRICES? ON EMPLOYMENT? ON INDUSTRY PROFITS?

-IS THE U.S. INDUSTRY IN A POSITION TO COMPETE EQUALLY AND FAIRLY WITH JAPANESE IMPORTS, OR IS THERE, AS THE CHAIRMAN OF THE CERYSLER CORPORATION HAS CLAIMED, A "TILTED PLAYING FIELD?"

The emphatic response to these questions from the nation's 7000 imported automobile dealers is that a free market will be best for America - best for the consumer, best for the worker and, in the long run, best for the industry.

If the automobile industry is not capable of continued existence without protection, then there is no industry in this country that can survive in a free market.

Japanese Car Sales In a Free U.S. Market

This committee has heard dire forecasts that, should the restraints on Japanese imports end, foreign made cars would seize forty percent of the domestic, U.S. market. Such calamitous predictions are based on the assumption that domestic manufacturers would maintain their present bloated price structure, even in the face of renewed price competition in the market. Such a premise is wholly unreasonable.

Detroit obviously has the capacity to reduce prices significantly while still maintaining reasonable profit margins. A ten percent reduction in automobile prices, according to industry

analysts, could bring from two to three million additional buyers into the market. Assuming a 12.5 million new car market under such circumstances, an increase in Japanese imports of 500,000 units would have a virtually imperceptible effect on their market share.

Ward's Auto World, the "bible" of the Detroit auto industry, estimates that Japanese manufacturers could not achieve U.S. sales in excess of 2.6 million units, even in the absence of any restraints. In a 12.5 million car market, this represents a market share of little more than 20 percent, virtually unchanged from the present figure. Even if sales did not exceed 11 million units - the sales projection most analysts are making in the assumption of no drastic price changes - 2.6 million Japanese car sales would represent only 23.6 percent of the market, a far cry from "the sky is falling" forecasts of a 40 percent market share.

Forty percent of a 12.5 million car market would represent five million Japanese car sales. Japan could not achieve such an increase in productive capacity in less than five years nor with a capital investment of less than $50 billion. To quote Ward's:

"To achieve 42 percent of the market, Japan would have to pre-empt the entire small-car, sporty-car and prestige-car market -- even though they'd have only 25 percent of the total market entries and merely 11 percent of retail franchises."

Even 40 percent of an 11-million car market would mean sales of 4.4 million Japanese cars, a 130 percent increase from present levels. Such astronomical growth is simply not in the cards. It is not even remotely possible under present circumstances.

Effect of the Quotas on U.S. Car Prices

As to the second question this committee must try to resolve, the effect of the restraints on domestic car prices, the U.S.

manufacturers have argued that new car prices have risen since the imposition of Japanese quotas at a rate less than the Consumer Price Index. The respected economic writer Robert J. Samuelson says auto executives, in making such statements, "are using government statistics either incompetently or dishonestly."

The Wharton Institute of Econometrics says that the selling prices of cars has increased since April, 1981 at a rate nearly double that of the CPI. Economist Robert W. Crandall of the Brookings Institute says automobile price increases as a result of the quotas may be as high as $800 per car.

If there is any question remaining that quotas have brought about higher car prices, it should be dispelled by the profit performance of the domestic automakers. According to the Wall Street Journal, GM is averaging a $3000 profit on each new vehicle retailed, after reaching break-even. Never in its history has the company made such a profit on each car sold.

Indeed, GM's net profit per new vehicle retailed during the last four consecutive quarters exceeds $1000. This is nearly four times the per car profit reported by the Toyota Company. The average price of GM cars sold is near $11,000.

Perhaps the best index of price increases is the amount of labor required of the average working person to purchase a new car. In 1980, before the quotas were imposed, the average factory worker could buy a new car with the proceeds from 32 weeks labor. By 1983, the purchase would require 38 weeks of his salary - a 19 percent increase in the amount of wages needed for the purchase. Based on BLS figures for average factory wages, the resulting increase comes close to Wharton Econometrics' estimate of a $2600

increase in automobile prices since the imposition of quotas.

The effect of automobile price scalation as a result of the Japanese VRA is felt throughout our economic and social structure. Not only have those who can still afford to buy a new car suffered from the higher prices and consequent transfer of discretionary purchasing power from other markets, there are millions more who have simply been pushed out of the new car market by higher prices and the unavailability of small, economy cars.

This group either is retaining their older cars through constant repairs, represented by a quantum increase in the amount now being spent on auto repairs over the 1980 level, or has turned to the used car market. Widespread retention of cars past their usual life cycle, combined with greater demand for used cars, has resulted in a scarcity of marketable used cars and a consequent sharp increase in used car prices.

In 1979, the average used car sold for $3600. In 1984, the average used car price has escalated 42 percent to $5100. The average used car is nearly five years old and has almost 50,000 miles on the odometer.

Consumer spending on auto repairs has increased by 13 billion, an 18% increase during the period of quotas, from $70 billion in 1980 to $83 billion in 1983, as those frozen out of the new car market by higher prices have struggled to keep their old clunker in operation. The average age of automobiles on the highways of America has increased to 7.5 years, the oldest our car population has ever been, even in the World War II years when production had halted.

The Tilted Playing Field

Finally, the committee must come to grips with claims regarding the tilted playing field. According to the Chairman of the Chrysler Corporation, Japanese automakers enjoy an "unfair" advantage over U.S. companies because of a combination of two factors - (a) a misaligned dollar and yen, and (b) tax advantages supposedly given the Japanese manufacturers by a benevolent government. Mr. Iacocca puts the advantage at $1600.

Nine hundred dollars of that cost advantage he credits to a supposed fifteen percent undervaluation of the yen. The yen, it might be added parenthetically, has remained closer to the soaring dollar than any other major national currency since the escalation of U.S. interest rates began in 1979.

Industry analyst Martin Anderson, however, puts the cost differential due to the yen-dollar relationship at "from $200 to $300," since "a big chunk of Japanese expenses and profits is not in yen and has nothing to do with the yen."

The balance of the cost advantage, according to the Chrysler chairman, is due to the fact that Japan (as does every other country that imposes a commodity or excise tax) does not charge this tax on exports. This supposedly gives the Japanese manufacturers a further $700 advantage.

A recent study by the respected Boston research firm of Temple, Barker and Sloan disputes this claim. The average Japanese car sold in this country, their report states, is actually more heavily taxed than its U.S. counterpart, carrying a tax and duty load of $2675 versus $2088 for an American-made car.

So much for the so-called "tilted playing field." There is

increasing evidence that the only cost advantages the Japanese automakers have over their American counterparts is a willingness to accept a lower profit level, more efficient manufacturing and management techniques and a more dedicated work force. These hardly commend adoption of protectionist measures for the U.S. industry.

The cost advantage supposedly enjoyed by Japanese manufacturers is a matter that the experts cannot agree on, no matter how many studies are done. The statements from Detroit focus on lower wage rates in Japan, but ignore those factors where the Japanese are at a definite cost disadvantage. American manufacturers enjoy lower land costs than their Japanese competitors, also lower energy costs and, overall, lower raw material costs.

American companies also pay a lower tax rate than do the Japanese. Where the American market is concerned, they also have lower transportation costs and, of course, they pay no duties. Due to their larger volume, Detroit companies have a lower per-car advertising and marketing cost.

The Japanese advantage in labor rates is undoubtedly real, but the actual difference is subject to interpretation. Any assessment of Japanese labor costs must take into consideration the companies' costs for subsidized housing for workers, for subsidized cafeterias, groceries, heating, etc. Factoring these costs into the labor rate greatly reduces the difference between U.S. and Japanese labor costs.

The greatest single item making up the difference between the two countries' wage rates is that Detroit companies must bear the full cost of their workers' medical insurance, while in Japan, the government provides full coverage medical care.

One area where American companies have a definite cost disadvantage is in the cost of capital. Interest rates in Japan are little more than half what they are in the United States. It is these soaring U.S. interest rates, of course, that have also created the misalignment between the dollar and other currencies, including the yen. Japanese firms rely far more on borrowing for their capital investment than do American firms. It is not unusual for a Japanese company to have a debt-to-equity ratio as high as 250 percent, whereas American firms grow uneasy (and so do their bankers) when the ratio nears forty percent.

U.S. firms' reliance on equity financing also forces them to pay out large sums in dividends on stock, in order to keep their stock priced high and to appeal to potential buyers. Japanese firms pay much lower dividends on the average, show far lower profit levels and are able to reinvest their earnings in new plants and equipment.

Reducing interest rates, which, of course, means bringing the Federal deficit into some more reasonable form of balance, would do more to improve the competitiveness of American auto manufacturers than any tinkering with trade restraints, quotas, tariffs or tax devices supposedly aimed at creating a "level playing field."

Effect of the Japanese VRA on the U.S. Auto Industry

Last year, Detroit's big three sold less than seven million new cars. This year, they will sell a little more than eight million. These are not blockbuster figures. They are dwarfed by the perceived demand for new cars, which industry observers put at 12.5 to 13 million cars.

Yet, off these mediocre sales figures, last year GM, Ford and Chrysler reported net earnings of more than six billion dollars, smashing by more than a billion dollars the record set in 1977 when they sold two million more cars than they did last year.

In 1984, the Big Three are expected to show profits of more than ten billion dollars, doubling 1977's record, while still selling a million fewer cars than they did that year.

The American public is awakening to the fact that Detroit has used the protectionism granted it by the Federal Government not to regain market share and re-employ its laid-off workers, but rather to raise prices to a point where profits-per-unit have reached historical highs. Nothing brought this point home to the consumer so sharply as the action of the auto companies in squandering their mind-boggling profits on lavish executive bonuses.

Executive bonuses paid recently for one U.S. company almost matched the cost of building the Volkswagen factory in Pennsylvania.

Executive salaries and bonuses paid by the auto companies have sharply focused the attention of three major elements of American society on the way Detroit has responded to the government's intervention in the market on their behalf.

-Labor, with an appetite whetted by Detroit's lavish bonuses and dividends, which will be aiming at substantial wage increases in this summer's negotiations, increases that will raise the manufacturer's cost for a single assembly line worker to more than $50,000 a year.

-Government, which, in the words of Trade Representative Bill Brock, feels that it has been "had", after negotiating a fourth year of quotas on Japanese cars in behalf of Detroit.

-and the Consumer, who, to quote from a popular movie of a few years ago, "is mad as hell and isn't going to stand for it any more."

Quotas and Their Effect on U.S. Production

The saddest aspect of Detroit's cowering behind protectionist barriers is that the restrictions on imports and the consequent higher prices for domestic automobiles are actually holding down U.S. sales, production and employment. According to Wharton Institute of Econometrics, the higher prices that have resulted from lack of import competition have done more to depress U.S. automobile sales than high interest rates, higher gasoline costs or any other single factor.

Dealers know that the pent-up demand for new automobiles has reached the explosive state. The American car-buyer is fed up with driving a seven-or-eight year old gas guzzler. He wants a new, fuel-efficient automobile. But millions either can't or won't spend $11,000 for a new car.

A ten percent price cut - which an end to import quotas could easily bring about - would sell an additional two to three million cars next year and would still give Detroit its most profitable year ever.

Three million additional car sales would put every one of the 100,000 unemployed auto workers back on the job - and create 100,000 additional auto industry jobs. It would create a broad industrial revival across this heartland of America, rejuvenating the iron and steel industry, the aluminum industry, the tire and rubber industry.

Industrial Policy in the Auto Industry

The chairman of the Chrysler Corporation was in Washington little more than a week ago, attempting to sell the Administration

and the Congress on his own concept for continuing the low-volume, high-profit operation that has provided such a windfall for the domestic companies and their executives. Mr. Iacocca calls his industrial policy the "Central America" plan.

Referring to the heartland states of Ohio, Michigan, Indiana, Illinois, Pennsylvania and Missouri as "Central America", Mr. Iacocca has tried to frighten the Republican Administration into adopting his own version of "industrial policy" by warning the White House that, otherwise, they stand to lose these great states and their huge electoral votes in the Fall election.

The Iacocca plan is simple. The Federal Government, the auto unions and the management of the Big Three automakers should sit down together and work out a program whereby the auto industry can continue to make record profits, pay the highest labor rate in the world, while dispensing lavish bonuses and dividends, all the while maintaining prices at sticker-shock level. Key to this plan, of course, is keeping out competition from those pesky imports.

Mr. Iacocca says it is necessary for the government to restrict imports because of the cost advantage Japanese manufacturers have over U.S. automakers. According to their annual reports, last year, GM made a net, after-tax profit of $912 on each car it sold. Toyota's profit was $263 per car. Perhaps the Japanese cost advantage is purely a willingness to settle for a smaller profit.

Before he invites the Federal Government into a partnership with management and labor to operate the automobile industry, Mr. Iacocca should take a look at some of the countries where this sort of program has been in operation for a number of years. Australia is one

country that comes to mind.

The Australian government has just announced its 25th new government auto policy in twenty years. Abrupt and sweeping changes in policy have been made every year since industrial policy was established in 1965. One Australian newspaper said, contradictorily:

"Our experience of chopping and changing plans for the car industry is anything but inspiring, but we are now so deep in the quagmire of local content plans, tariffs, quotas and export incentives that we can be pulled out of it only by the government."

Meanwhile, all Australian auto companies have been and are losing money at an appalling rate. The same is true for auto manufacturers operating in other countries where the government takes an active role in "protecting" their industry, notably Brazil, Argentina, and Mexico. Sales for Mexico's government-controlled industry have dropped to less than 14,000 cars a month. Sales are down 40 percent from 1981.

This all brings to mind that, if you're an admirer of the economies of Mexico, Argentina or Brazil, you'll probably love Mr. Iacocca's Central America plan.

Background of the Protectionist Movement in the U.S. Auto Industry

Protectionist pressure in automobiles dates to 1980, when the industry attempted but failed to receive escape clause relief under Section 201 of the Trade Act of 1974. Despite an intensely political atmosphere, the United States International Trade Commission determined that imports were not a substantial cause of injury or

threat thereof to the U.S. industry. Instead, the Commission found that recession, high interest rates, and the shift in consumer demand toward small, fuel-efficient cars were the principal causes of Detroit's distress.[1] Failing to secure protection through established procedures, the industry brought direct pressure on Congress to enact highly restrictive quotas on imported automobiles (the "Danforth Bill"). In early 1981, with the fate of that legislation uncertain, Japan succumbed to strong pressure from the Reagan Administration and agreed to roll back and limit auto exports to the U.S. market to 1.68 million units per year for three years. Despite strong recovery in the United States industry evident by Fall 1983, the Japanese were pressured into extending the VER program an additional year to March 1985 at the level of 1.85 million units. One can only speculate on why Japan agreed to extension, but certainly the misalignment of the dollar, Japan's massive trade surplus with the United States, and the drumbeat of anti-Japanese statements emanating from Congress and some parts of the Administration, must have influenced its decision.

The Economic Condition of the United States Automobile Industry

What are the facts? Does Detroit need protection of any kind? By virtually any measure the United States auto industry is in a remarkable recovery from the recession of 1980-82. Table 1 displays the impressive turnaround since 1981:

- sales are up 24% in volume
- value of shipments are up 55%
- consumption of autos is up 20%
- average car prices are up 33%

Total average employment is up 13% from 1982 to 1983, with 100,000 production workers recalled during 1983. The unemployment rate has been cut from 23% to 10% from year-end 1982 to year-end 1983, and the majority of those now unemployed in the domestic industry have been the victims of automation and robotics, not of Japanese import competition.

Table 1

United States Auto Industry

Profile of Recovery[a]

	1981	1982	1983	1984 Estimated	Percent Change 1981-1984
Sales (millions cars)	6.2	5.7	6.9	7.7	+24%
Value of Shipments (billion $)	74.3	70.6	97.9	115.4[b]	+55%
Consumption (millions cars)[c]	8.5	8.0	9.2	10.2	+20%
Employment (thousands workers)	272	244	265	275	+ 1%
Unemployment Rate (%)[d]		23	10		

	1981	1982	1983	1984 Estimated	Percent Change 1981-1984
Average New Car Price ($)[e]	8,850	9,910	10,725	11,780[f]	+33%
Profits (billions $)	-1.3	-1.3	6.1	10[g]	+525%[h]

a) Source U.S. Industrial Outlook 1983 unless otherwise noted
b) Estimated using average annual price increase 1982-1983
c) Includes imports
d) Year-end
e) Automotive News 1984 Market Data Book
f) Trend projection
g) Estimate, New York Times April 16, 1984
h) From 1982

Profit figures are dramatic. Total industry earnings for 1983 were $6.1 billion, more than wiping out the prior cumulative three years' loss of $5.2 million. 1983 earnings by company were:

General Motors	$3.7 billion
Ford	$1.9 billion
Chrysler	$0.7 billion
American Motors	-0.1 billion

These provide remarkable profits per car sold. For example, with 93% of its earnings attributed to U.S. operations, General Motors' profit per U.S. car produced amounted to $868.[1/] Profits for the industry are expected to grow an additional 64% in 1984 and reach a record $10 billion. Nor has executive compensation been neglected. The Chairman of General Motors, Roger Smith, received $1.5 million and the Chairman of Ford, Phillip Caldwell, $7.3 million in pay, bonus, and stock options in 1983, for heading a company that earned $1.87 billion in 1983. Overall,

General Motors paid 5,807 executives $181.7 million in bonuses in 1983; Ford paid 6,035 executives 1983 bonuses totalling $80.6 million.

It is now clear that the strategy of the U.S. auto makers is to use the protection provided by the VERs with Japan to maintain and increase car prices, building high profits per unit sold, rather than to lower prices and attempt to regain market share lost to imports.

And indeed the industry is substantially restructured and revitalized, and able to make profits at much lower production levels than previously. Between 1978 and 1982 domestic auto producers invested over $51 billion, mostly in the United States, in new plant, equipment, and tools, in order to build more fuel efficient and higher quality cars.

Voluntary Restraint Agreement on Automobiles

Given Detroit's profitable position, there is no reason to continue to saddle the U.S. consumer with the burden of higher prices resulting from the quota limits on Japanese cars. Preliminary work by Robert Crandell of The Brookings Institution indicates that quotas can be blamed for $400 in the cost of 1983 American cars--or $3.5 billion of the American companies' 1983 pre-tax revenues. Wharton Econometrics has documented a $2,600 per car increase in the price of domestic cars since the VER went into effect. That works out to a 35% price increase--double the rise of the Consumer Price Index

over the same period. For the American consumer, the restraints have been a very expensive experiment--as anyone in this room knows who has tried recently to purchase an automobile, prices for both American and Japanese cars have soared to the $10,000 plus range.

As the following tables indicate the VER has created an artificial scarcity of cars by reducing at least by 1.543 million units the level of Japanese car imports into the United States in the 1981-1984 period.

The Impact of U.S. Japanese Import Restraints, 1981-84 [2]

Lost Sales (000's)

	Japanese Fiscal Years					
Japanese Volume	1981	1982	1983	1981-83 Avg.	1984	1981-84 Total
Actual	1777	1827	1850	1818	1932*	7386
Potential	2051	2113	2331	2165	2434	8929
Lost Sales	274	286	481	347	502	1543
% Industry	3.4%	3.6%	5.0%	4.0%	4.8%	4.3%

*estimate

The Impact of Japanese Import Restraints 11/

Lost Sales (000's)

	Japanese Fiscal Years				
Manufacturer	1981	1982	1983	1981-83 Avg.	1984
Toyota	(39)	(85)	(145)	(106)	(143)
% Loss	32%	30%	30%	30%	29%
Nissan	(62)	(73)	(132)	(90)	(139)
% Loss	23%	26%	27%	26%	28%
Honda	(63)	(63)	(100)	(75)	(95)
% Loss	23%	22%	21%	22%	19%
Mitsubishi	0	(2)	(10)	(4)	(15)
% Loss	-	1%	2%	1%	3%
Mazda	(27)	(28)	(53)	(36)	(64)
% Loss	10%	10%	11%	10%	13%
Subaru	(16)	(18)	(20)	(18)	(21)
% Loss	6%	6%	4%	5%	4%
Isuzu	(3)	(3)	(3)	(3)	(3)
% Loss	1%	1%	1%	1%	1%
Captive	(14)	(14)	(18)	(15)	(22)
% Loss	5%	5%	4%	4%	4%
Total	(274)	(286)	(481)	(347)	(502)
% Industry	3.4 pts.	3.6 pts.	5.0 pts.	4.0 pts.	4.8 pts.

The idea of protecting Detroit as an "infant industry" was ludicrous in 1981. AIADA demonstrated to the International Trade Commission in 1980 that imports were not the problem for the domestic industry, but, due to political pressurs, a VER was put into place. Let us not convert this "infant industry" subsidy for Detroit into an old age pension.

We agree with the United States Trade Representative William E. Brock's statement on May 2, 1984, that the "voluntary" quotas on Japanese cars should not be renewed when they expire in March, 1985. Ambassador Brock has objected to the big bonuses paid to U.S. auto executives, and asked, if the industry is healthy enough to pay such compensation to its executives, "then why does it need protection? Do the American people really want to subsidize as much as $5 million or more in bonuses for one manager?" Summarizing our views, Ambassador Brock went on to state, "It's hard not to feel a little bit 'had' at this point". He went on to state: "Protectionism becomes addictive. It becomes tantalizing to ask for more and more. But it doesn't deal with the problem."[3]

We agree with the Fortune magazine article of June 25, 1984, that: "Quotas are a sometime thing. In the long run jobs can be preserved only by a competitive labor force." Moreover, we urge the immediate elimination of the VER. It makes no sense to acknowledge that this trade restraint is a bad idea, but agree to carry it out for another year. In the intervening year, the American automobile consumer will lose at least $5 billion in purchasing power and Detroit's economic royalists will lavish even higher bonuses on themselves.

Toward an Open World Economy

Trade is a way of life in Japan. We need to accept it as a way of life in the United States. In 1950, 2% of the U.S. Gross National Product (GNP) was involved in trade; it is now 20% of the U.S. GNP and by the year 2,000 may be 40% of the GNP. As the United States becomes more integrated into the global economy, frictions will increase with our trading partners, but so will opportunities for all Americans, including small businessmen such as automobile dealers.

We can fight this global integration or adapt to it. Protectionism will not maximize our national income. On the other hand, the steps we take towards an open world economy will maximize the U.S. production possibilities curve, bring lower prices to the U.S. consumer, act as a prod to innovation in the U.S. economy, be the best antimonopoly policy that the United States could adopt, and contain inflation. Apart from economic considerations, an open economy would stimulate favorable diplomatic fall-out. On the other hand, relations with our trading partners would be embittered and American influence throughout the world would be reduced by a policy of protection.

The solution to the problems of the domestic auto industry (with a $10 billion profit this year, all industries should have such problems!) is not less, but more free enterprise. Let the cold wind of competition bring down the overheated price structure of the industry and we will see a solid, honest and permanent resurgence of America's heartland.

Let our philosophy be, as Franklin Roosevelt proposed,

"not that the system of free, private enterpise has failed in our generation, but that it has not yet been tried."

Notes

1. USITC Pub. #1110, December, 1980.

2. Ward's Research, March 31, 1984, Exec. Summary, P. 4.

3. The Washington Post, May 2, 1984, P. A1.

Senator DANFORTH. Mr. Crandall, I am glad you are here. We have been looking forward to your being here. I know it has been a busy day for you in the Capitol.

STATEMENT OF ROBERT W. CRANDALL, SENIOR FELLOW, THE BROOKINGS INSTITUTION, WASHINGTON, DC

Mr. CRANDALL. Thank you, Mr. Chairman. I am sorry I am late. I was testifying before another committee in the same building here, and it ran longer than expected.

Senator DANFORTH. I know exactly how you feel. [Laughter.]

Mr. CRANDALL. I have a statement which I have given your staff, which I would ask be submitted for the record. Given the lateness of the hour, I will be very brief and try to summarize it. It is a preprint of an article which will be in the Brookings Review next month on the effect of the auto import quotas.

I am an economist for Brookings Institution, and I offer the usual disclaimer that what I am about to say will be my own views and not necessarily those of anyone associated with the Brookings Institution.

Senator DANFORTH. Well, we'll blame them, anyhow.

Mr. CRANDALL. That's what usually happens, but my colleagues insisted I say that.

In the paper which I have submitted for the record I go through the sad history of what has happened to our auto industry in the last few years, detailing the effects of the rising value of the dollar, increasing labor costs, and increasing regulatory costs, particularly the increase in regulatory costs immediately after the Iranian revolution and the second rise in oil prices.

All of these were sort of prologs to the quotas, which as you know were put in place in 1981.

The second half of my statement tries to get at the question how much these quotas have raised the prices of automobiles, and I

submit that this is a very difficult question to ask and one for which I do not have a full answer.

At present, we do not know how much downward pressure the Japanese would have put on our prices, given that their yen continued to depreciate against the dollar after April 1981—it is about 10-percent lower now than it was then—given that their cars have continued to improve in quality, and given that the Consumer Reports ratings of repair frequency continue to show an improvement in the Japanese cars relative to the American cars, over at least the early part of the quota period. It is very difficult to know how much downward pressure might have been put on prices.

But what I can say is that it appears that U.S. car prices have probably risen by about $400 a car over this period above what one would have expected had normal conditions obtained.

The Japanese list prices have increased at least a $1,000 a car and probably substantially more than that in transaction prices, but we don't have adequate data on what dealers are actually getting for Japanese cars.

U.S. automobile industry officials often assert the quotas have not raised U.S. car prices. If the quotas only had the effect of increasing U.S. output and employment and not raising U.S. prices, that would have been a curious policy for our Government to undertake, because these quotas have increased the profits to the Japanese by somewhere between $1.7 and $2 billion a year, at least, before their taxes; while they could have only increased our profits from an expanded market share by maybe $1 to $1.5 billion. That is a curious form of protection, or revitalization of our industry. If the premise of the quotas is to increase the cash flows temporarily so as to allow the industry to reinvest, we are getting more cash flows under this argument than the Japanese, and presumably they are reinvesting to be "leaner and meaner" yet when we drop the quotas.

In fact, I think these quotas have had a substantial price effect on American cars. I think that the total cost to American consumers has been somewhere between $4 to $5 billion a year and that the direct employment effect in the auto industry may have been somewhere between 40,000 and 50,000 jobs; but that has probably been offset substantially by the feedback effects on other industries, particularly the exporting industries.

Finally, I agree with the previous witness that the profit levels of the companies have expanded tremendously. In 1983 they earned in real terms—not in nominal dollars but in real terms—a profit-per-vehicle which is equivalent to what they would have earned in the past in a year of 8.5 to 9 million car sales; but they earned that profit level in a year when they only sold 6.4 million cars.

Now, it is possible that the auto industry has made some miraculous improvements in productivity and cost-savings, but I would guess that a large part of the improved real profit per car is due to the enhanced prices they have been able to get due to import quotas.

Senator DANFORTH. Thank you all very much.

[Mr. Crandall's prepared statement follows:]

Testimony

of

Robert W. Crandall

The Brookings Institution*

before the United States Senate Committee on Finance, June 27, 1984

*The views expressed in this statement are the author's and do not necessarily reflect the views of the officers, trustees, or other staff of the Brookings Institution. Mr. Crandall is a senior fellow in the Economic Studies Program at Brookings.

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Import Quotas and the Automobile Industry: The Costs of Protectionism

Robert W. Crandall

The American automobile industry had a very good year in 1983: New car sales jumped up by nearly one million units, and, as has been well-publicized, after-tax profits soared to a record $6.2 billion. But the industry is not quite as robust as these statistics suggest. U.S. automobile companies have been playing with a home-field advantage -- quotas on Japanese imports, negotiated in 1981 and now extended through 1985.

This article explores the effects of the quotas -- on automobile prices and on the profits of domestic manufacturers. The essay begins, however, by tracing the recent history of the automobile industry; it is important, in assessing the impacts of the quotas, to understand why they were sought in the first place.

The Past as Prologue

Sales. Before the 1958 recession, the U.S. automobile industry appeared to be a stable, invincible oligopoly. From time to time, ardent trustbusters would suggest that the government should initiate antitrust

proceedings against General Motors in order to increase competition in the industry. It seemed highly unlikely that foreign producers would ever be able to capture a substantial share of the U.S. market. Although Volkswagen enjoyed some success in the late 1950s, import sales then tapered off -- dropping below five percent of total sales by 1962, as Table 1 indicates.

That decline proved to be short-lived; in the next eight years, the proportion of U.S. sales accounted for by imports tripled, settling at about 15 percent for the years 1970-74. Ford and General Motors responded to the stepped-up competition from small imported cars by launching their Pinto and Vega model lines, but neither of these proved particularly successful. When the second oil shock occurred in 1978-79, fuel-efficient foreign cars became more popular than ever; in 1980, 28 percent of the new cars registered were imports.

While the sales of imports have increased since 1965, growth in the demand for new cars has decreased. From 1965 through 1970, sales were essentially flat, deviating little from an annual rate of nine million cars; this leveling-off came after more than a decade of substantial sales growth. Sales were at a higher plateau between 1971 and 1979, averaging about ten million cars per year, but most of this increase was absorbed by imports, particulary those from Japan. As a result, even during the relatively prosperous period of 1976-79, the demand for domestic cars was about the same as it had been in 1965-66. That demand then plummeted during the first four years of the 1980s, as U.S. manufacturers managed to sell only about 6 million new cars per annum -- far below their totals in the recession-plagued years of 1970 and 1975.

Table 1

U.S. New Car Registrations - 1960-1983
(millions)

Year	Domestic Cars	Imports	Total	Import Share
1960	6.1	0.5	6.6	7.6%
61	5.2	0.4	5.6	6.5
62	6.6	0.3	6.9	4.9
63	7.2	0.4	7.6	5.1
64	7.6	0.5	8.1	6.0
65	8.7	0.6	9.3	6.1
66	8.3	0.7	9.0	7.3
67	7.6	0.8	8.4	9.3
68	8.4	1.0	9.4	10.5
69	8.3	1.1	9.4	11.2
70	7.2	1.2	8.4	14.7
71	8.5	1.3	9.8	15.1
72	9.0	1.5	10.5	14.5
73	9.7	1.7	11.4	15.2
74	7.3	1.4	8.7	15.7
75	6.8	1.5	8.3	18.2
76	8.4	1.4	9.8	14.8
77	8.8	2.0	10.8	18.3
78	9.0	1.9	10.9	17.8
79	8.0	2.4	10.4	22.7
80	6.3	2.5	8.8	28.2
81	6.0	2.4	8.4	28.8
82	5.5	2.3	7.8	29.3
83	6.4	2.5	8.9	27.5

Source: Automotive News.

As Table 2 shows, the profit rates of U.S. automobile manufacturers fluctuated wildly during the 1970s, ranging between 6.1 percent and 18.7 percent on equity. Then, in 1980, the bottom fell out; the firms lost $4 billion on sales of 6.3 million cars. This was the worst year in the industry's history; its profit rate of -9.3 percent was 23.2 percent below the averge for all manufacturing. When sales had declined sharply in 1970 and again in 1975, U.S. manufacturers had managed to earn positive rates of return. In 1961, with sales of only 5.2 million cars, the companies had earned 11 percent on equity. Clearly, the industry's difficulties in 1980 -- and in the two years that followed -- reflected more than just cyclical swings in the economy. What had gone wrong?

Regulation. One source of vexation has been the federal government, which has saddled the industry with a succession of new regulatory requirements. Safety regulation began in 1966, federal emissions controls in 1968, and fuel-economy regulation in 1978. The costs of safety and emissions regulation have been substantial; as Table 3 shows, they reached nearly $2000 per car by the early 1980s.

Prior to 1972, emissions control costs were negligible, and safety equipment costs were less than $200 per car. Both categories of costs then rose sharply, however. Automobile manufactueres struggled with the tecnnology of emissions control while trying to convince the government that its timetable for control was much too stringent. For at least two years and perhaps longer, the companies used relatively inefficient fixes to

Table 2
After Tax Rate of Return on Equity-U.S. Automobile Companies, 1960-1983

Year	Motor Vehicles	All Manufacturing
60	13.5	9.2
61	11.4	8.8
62	16.2	9.8
63	16.7	10.2
64	16.9	11.6
65	19.5	13.0
66	15.9	13.4
67	11.7	11.7
68	15.1	12.1
69	12.6	11.5
70	6.1	9.3
71	13.0	9.7
72	14.6	10.6
73	15.3	13.0
74	7.0	14.9
75	6.2	11.6
76	17.0	14.0
77	18.7	14.2
78	17.0	15.0
79	10.9	16.5
80	-9.3	13.9
81	-0.7	13.7
82	0.9	9.2
83	16.7	10.1

Source: Federal Trade Commission.

Table 3
The Cost per Automobile of Federal Safety and Emissions Regulation, 1966-81
(current $/car)

	Equipment Costs			Total Costs
Year	Safety	Emissions	Total	(Including Maintenance & Fuel Economy Penalty)
1966	40	0	40	40
1967	73	0	73	73
1968	115	14	129	129
1969	129	15	144	144
1970	157	24	181	181
1971	166	25	191	191
1972	171	25	196	366
1973	258	44	302	790
1974	380	49	429	970
1975	358	119	477	664
1976	373	126	499	696
1977	384	123	507	850
1978	393	133	526	895
1979	421	148	569	980
1980	467	222	689	1373
1981	494	600	1094	1894

Source: Crandall, et. al., Ch.3.

constrain emissions. The results were poor performance, severely depressed fuel economy, and widespread customer dissastisfaction.

At about the same time, The Department of Transportation was imposing two major new safety regulations on the industry -- requirements for seat belt interlocks and energy-absorbing bumpers. The interlock requirement was quickly repealed by Congress in response to bitter complaints from new-car buyers, but manufacturers had already spent time and money on the design and fabrication of interlock systems. The bumper requirement was surely a masterstroke of bad timing; it added substantially to the weight of cars -- and detracted significantly from their fuel economy -- just as the Arab oil embargo was driving gasoline prices up.

The second big regulatory surge came in 1980-81. The industry managed to stave off a new requirement for passive occupant restraints, but only at the last minute. Product planners had to be prepared to install passive seat belts or air bags in some models in 1982 before the Department of Transportation relieved them of this requirement in mid-1981. In addition sions standards were tightened substantially in 1980-81 necessitating major changes in ignition systems and control devices.

Unfortunately, these regulatory initiatives came right after the second oil shock and an attendant surge in the sale of Japanese imports. At the same time that U.S. manufacturers were struggling to redesign and downsize their cars as quickly as possible, they had to introduce new emissions-control technologies and to develop passive restraint systems. The Japanese car companies appear to have adjusted to the regulatory requirements more

readily than their American rivals, perhaps because they did not need to downsize their product line simultaneously.

Many of the safety equipment requirements, and at least the early phases of emissions controls, appear to have been effective, but the gains they produced have not been without their costs. For consumers, safety and emissions standards have increased the prices of new cars by at least $1000 and reduced both fuel economy and performance; for automobile companies, as a result, they have reduced the demand for new cars. Had emissions controls been kept at 1979 levels and the energy-absorbing bumper left a matter of market choice, new car sales would have been higher and regulatory headaches fewer for an increasingly besieged Detroit.

More recently, the Corporate Average Fuel Economy (CAFE) standards, legislated by Congress in 1975 and implemented by the Department of Transportation, have placed U.S. companies in the difficult position of trying to meet the resurgent demand for larger cars while still making progress towards the 1985 goal of 27.5 miles per gallon for their fleets.

Product Quality. An unfortunate consequence of the turbulence of the 1970s was a sharp decline in the product quality of U.S. automobiles relative to that of Japanese imports. This decline was reflected not only in the "fit and finish" of cars -- that is, the fit of body panels and the general quality of exterior finish -- but also in the frequency of repairs. In 1970, as Table 4 shows, the repair records of U.S. cars were only marginally worse than the records of Japanese imports in the first few years of service. These differences may have narrowed or disappeared in later

Table 4
Average Consumer Reports Quality Ratings
for U.S. and Japanese Cars

Year	Japanese Imports	G.M.	Ford	Chrysler
1970	2.33	2.81	3.18	3.85
1976	1.13	3.03	2.80	3.91
1981	1.05	4.33	3.17	4.50

Note: 1=Much Better than Average
2=Better than Average
3=Average
4=Worse than Average
5=Much Worse than Average

Source: Consumer Reports, April 1972, April 1978 and April 1983.

years of service. By 1976, however, Japanese cars had much better repair records than their American counterparts -- and this gap has persisted and even widened in the years since then. It should be noted that the continuing declines in quality reported in Table 4 are not confined to the new downsized front-wheel drive models, but have occurred across the entire model lines of the U.S. companies.

Production Costs. The quality advantage of Japanese cars was no doubt one factor in the shift of American buyers toward imports; another factor was the loss of U.S. competitiveness in the production of smaller cars. Since 1980, there have been numerous attempts to quantify the differences between U.S. and Japanese production costs for subcompact cars. Estimates of the Japanese advantage range from $1300 to $2500 per car, a substantial fraction of the average delivered price of these models. Those who have studies this question agree that the main sources of the cost disparity are differences in wage rates, labor productivity, management practices, and inventory costs.

Part of the U.S. industry's problem derives from its own collective bargaining; it has granted large wage increases to its unionized workers rather than risk strikes or labor unrest. As indicated in Table 5, the result has been hourly employment costs that are about 60 percent above the average for all U.S. manufacturing firms. In Japan, by contrast, automobile companies pay their workers only 25 percent more per hour than what the average Japanese industrial worker receives. Moreover, the differences between the hourly employment costs of U.S. and Japanese car manufacturers

Table 5
Total Hourly Compensation in the Motor Vehicles Industry and All Manufacturing-U.S. and Japan
($/hour)

	U.S.		Japan	
Year	Motor Vehicles	All Manufacturing	Motor Vehicles	All Manufacturing
1975	9.44	6.35	3.56	3.05
1976	10.27	6.93	4.02	3.30
1977	11.45	7.59	4.82	4.03
1978	12.67	8.30	6.85	5.54
1979	13.68	9.07	6.90	5.49
1980	16.29	9.89	6.89	5.61
1981	17.28	10.95	7.65	6.18
1982	18.66	11.68	7.18	5.70
1983	19.02	12.31	7.91	6.24

Source: Bureau of Labor Statistics

has been widening -- from about $6 in the mid-1970s to about $11 now -- even though productivity growth in the Japanese firms has been more rapid.

In 1982, the UAW agreed with Ford and GM to forego some wage increases in order to stem the flow of red ink from these companies' domestic financial statements. These agreements followed similar, but larger concessions granted to Chrysler in previous years. In addition, the industry has attempted to increase productivity by investing in labor-saving equipment and improving worker morale. At this juncture, there is insufficient evidence to judge the success of these attempts. Indeed, General Motors' decision to produce subcompacts jointly with Toyota in California appears to be an attempt to break out from the restrictive work rules with which it is saddled in other plants.

Paying for Protection: The Import of Quotas

In 1980, the U.S. industry began to appeal for temporary protection from Japanese imports. In July, 1980, the International Trade Commission initiated an investigation under Section 201 of the Trade Act of 1974. This proceeding did not result in an ITC decision to recommend trade relief measures. In 1981, however, President Reagan announced that agreement had been reached with Japan on a voluntary export restraint (VER) that would limit Japanese automobile exports to the United States, beginning that April, to 1.68 million cars per year.

The Reagan decision did not arouse much opposition since it followed a year in which U.S. automobile manufacturers lost approximately $4 billion. Employment in the industry had fallen by more than 20 percent; approximately a third of that decline was due to a sharp rise in import sales. Moreover, the Chrysler Corporation had recently been saved from bankruptcy by federal loan guarantees, and Chrysler workers had taken substantial pay cuts.

The voluntary export restraint negotiated with Japan was renewed in 1983 for the 1984-85 period, but with a slightly higher limit of 1.85 million cars per year. By 1983, however, the industry had returned to at least the appearance of financial health, generating more than $6 billion in after-tax profits. The price of Japanese cars surged, U.S. manufacturers paid substantial bonuses to their executives, and commentators began to question the wisdom of continuing the restraint agreement with Japan.

The Rationale. The Reagan administration obtained temporary quotas on Japanese imports in order to buy the U.S. automobile industry and its workers time to adjust to the new rigors of world competition. It anticipated that during this adjustment period, car companies might undertake the substantial tooling required for the manufacture of new models, launch major investment programs designed to lower production costs in existing plants, establish new plant configurations, reduce inventory costs, and seek changes in union work rules and wage agreements. After a few years, the industry would be able to compete effectively once again -- unless its cost disadvantages were rooted in fundamental economic forces beyond its control, such as exchange rates, raw material costs, or a shift of comparative advantage to lower-wage countries.

There was and is another possible outcome: Trade protection might simply provide an opportunity for increases in automobile prices, wages, and company profits. A reduction in the availability of imports inevitably increases the demand for U.S. automobiles, opening the door for price hikes. The resulting increases in profits could provide an enticing target for union negotiators in the next round of bargaining. With foreign competition temporarily (or permanently) reduced, workers have less incentive to moderate their wage demands or to allow fundamental changes in work rules.

Which of these outcomes seems more likely? Past experience with trade restrictions hardly suggests that they offer a guarantee of industrial renaissance. The steel industry has enjoyed some form of protection over most of the past fifteen years, but it has not recovered. Trade protection for manufacturers of television receivers or shoes have hardly returned the U.S. to a dominant position in these industries. If past experience is any guide, one should not expect the Japanese VERs to be a miracle cure for the U.S. automobile industry.

The Industry's Adjustment. In fact, U.S. companies had begun to adjust to the new world of high gasoline prices and international competition some time before the VERs took effect. There is every reason to believe that the industry was well on its way to renewed competitiveness. Manufacturers had focused more on small cars since the two oil shocks, and by 1981 had reduced the average weight of a domestic car 30 percent from its 1972-73 high. Similarly, by 1980 the industry was selling 40 percent of its cars with four-cylinder engines, up sharply from 9 percent in 1972-73. Fuel economy was up by more than 25 percent over what it had been in 1972-73 for cars of

the same weight and horsepower; actual fuel economy increased much more than that, as buyers shifted to smaller cars.

The investment expenditures of the automobile companies are further evidence of their pre-1981 adjustment efforts. Between 1975-76 and 1979-80, as Table 6 shows, real investment outlays increased by more than 88 percent. More focused census data show that investment in plant, equipment, and special tooling rose more than 87 percent over the same period. In short, the industry had invested enormous sums in new models before the establishment of quotas. Since 1981, real investment expenditures by the automobile industry have fallen by 30 percent. Buyers have begun once again to demand larger cars; eight cylinder cars accounted for 31 percent of 1983 sales, up from 24 percent in 1981. New or modified models abound: Ford has introduced a new series of front-wheel drive cars and a modified version of its older rear-wheel drive Thunderbird; Chrysler has added a new sports car and a series of vans to its product line; and General Motors has downsized its larger cars. But the major changes were in place before the quotas were; by March, 1981, Ford's Escort, Chrysler's Aries-Reliant, and General Motors' X-, J-, and A-body cars were either on the market or nearly ready for introduction. It is difficult to trace any differences in product offering to the quotas.

Nor has productivity soared as a result of the quotas. Between 1977 and 1982, productivity growth in the motor vehicle industry was 0.4 percent, as compared with 0.2 percent in the nonfarm business sector. From 1980 to 1982, the industry outperformed the rest of the nonfarm business economy, but, given the depth of the 1982 recession, it is difficult to draw any firm

Table 6
U.S. Motor Vehicle & Equipment Producers'
Gross Investment Expenditures
1970-83
($/million)

Year	Current$	1972$*
1970	3050	3341
1971	2420	2516
1972	3000	3000
1973	3830	3630
1974	4300	3726
1975	3350	2534
1976	3620	2612
1977	5820	3978
1978	7215	4590
1979	8305	4862
1980	9060	4866
1981	10078	4992
1982	7920	3777
1983	7233	3496

*Using BEA Implicit Price Deflator for Nonresidential Plant & Equipment.
Source: U.S. Department of Commerce

conclusions from these data. When 1983 data become available, we may be able to say a little more about the impact of recent attempts to streamline automobile production processes.

Effects on Automobile Prices. There is no doubt but that by creating an artificial scarcity of Japanese imports, the voluntary restraints have increased the prices charged for these cars; the only question is by how much. A 1983 Wharton Econometrics study estimated that as a result of the quotas, the prices of Japanese imports jumped up an average of $920 to $960 per car in 1981-82 alone. With the surge in demand that took place in 1983, this price effect has surely increased substantially -- which means that our assistance for the U.S. industry has benefited Japanese producers and their dealers by at least $2 billion per year in price enhancement! From the standpoint of American taxpayers, a tariff clearly would have been a better policy choice than the voluntary restraints.

The effect of the restraints on the prices of U.S. cars is more open to dispute. It is not easy to estimate this effect because the mix of automobiles is constantly changing. Indeed, some industry officials believe that any recent price increases above the cost of producing cars have been due to mix changes, not imports. But if the VERs reduce the potential supply of new Japanese cars in the United States (and they surely do), they must increase the demand for American automobiles. Historically, the average price of automobiles in the United States has varied directly with the strength of demand; therefore, one would expect the VERs to increase the prices of domestic cars.

Assume for a moment that the VERs have simply increased the U.S. industry's market share by 5 to 8 percent, without increasing prices; given the trend in import sales between 1978 and 1981, this range probably represents the maximum effect of the quotas on market shares. In 1983, a 5 to 8 percent shift would have meant the purchase of an additional 445,000 to 712,000 domestic cars, assuming no effect on total car sales. My current research suggests that the marginal profit on these cars, before taxes, would have been about $2,000 per car -- for a total of $0.89 to $1.42 billion, less than the gain realized by Japanese companies and their dealers. (Of course, if the VERs have increased domestic car prices, then the additional profits made by U.S. manufacturers would be substantially higher.)

I used several techniques to estimate the impact of the quotas on domestic car prices, and while I would not claim that the results of any one of the tests are definitive, the fact that the outcomes are so similar does suggest that the price effect of the quotas is in the range indicated.

One way to gauge that effect is to relate U.S. car prices to costs and demand over a substantial period of time and then to use the resulting equation to predict prices under the VERs in 1981-83. I developed a pricing model for the period 1961-80, incorporating labor costs, capital costs, regulatory requirements, the price of steel, the strength of demand, and dummy variables for years of price controls. As indicated in part 1 of Table 7, the model tracks the annual average prices of new cars in this 20-year period with an average error of only about $56. However, the equation underestimates prices for 1983 by more than $800 per car and for 1981-83 by

Table 7
Three Estimates of the Effect of Quotas
Upon U.S. Car Prices

1. Average Price of New Domestic Cars Sold = f(Labor Cost, Capital Cost, Regulatory Cost, Price of Steel, 1972-74 Price Controls, Vehicle Sales)
Period of Estimation: 1961-1980 Standard Error: $56

Excess of Actual Prices over Predicted Prices:

1981	$237
1982	$236
1983	$829

2. Hedonic Model: Price of a New Domestic Car = f(WEIGHT, RIDE, HANDLING, ACCELERATION, SIZE CLASS, GASOLINE COST, DUMMY VARIABLES FOR VARIOUS YEARS)
Period: 1970-83 Models, 172 cars.

Increase in estimated value during quota years for small cars:

Year	Total ($/car)	Additional Regulatory Costs ($/car)	Net Value ($/car)
1981-83	826	454	372

3. Annual Increase in Consumer Price Index:

Period	(1) Total CPI	(2) New-Car CPI	(2)/(1) Ratio
1960-70	2.7%	0.3%	0.11
1970-80	7.5	5.1	0.68
March 1981-Dec. 1983	4.9	4.5	0.92
March 1981-Dec. 1983 (at 1970's ratio)	4.9	3.3	0.68

Difference in behavior of New Car CPI relative to total CPI in March 1981-December 1983 compared with 1970's:

4.5 - 3.3 = 1.2% per year

Effect on new domestic car prices of 1.2% greater increase per year

Actual 1983 Average Price	Predicted 1983 Average Price	Difference
$10,484	$10,116	$368

a yearly average of $430. Since the model was built using the Commerce Department's series on actual transactions prices, it relfects discounts from list prices. It does not, however, standardize for changes in the mix between small and large cars or in the mix of options. These changes occurred in the 1960s and 1970s, and the equation tracked prices very well for those two decades. The only major difference between the 1970s and, say, 1983 is tne presence of an import restraint; it seems reasonable to infer that the VER must account for a substantial share of the excess of actual prices over predictions.

A second method for analyzing shifts in automobile prices is the use of a so-called hedonic model that reflects the qualitative attributes of each car. I gathered data on 176 domestic models tested by Consumer Reports from 1970 through 1983; complete data were available for 172 of these cars. The following factors were included in the model: weight, acceleration, the estimated quality of ride, the estimated handling capability, the cost per mile of gasoline consumed, and the size-class of the car (subcompact, compact, intermediate, full size, or luxury). When specific dummy variables are used for each year, the model estimates that the real list price of small cars increased by 12 percent, or $826 per car, in the 1981-83 period. These increases in the real price of cars, holding the qualitative attributes constant, include the effects of tighter emissions control standards set by the government in 1980-81. These standards added $454 (1982$) to the cost of small new cars, which must be deducted from the estimated increase in the real, quality-adjusted price. Thus, as shown, in part 2 of Table 7, the hedonic model estimates that the quotas increased list prices by an average of about $370 per car in 1981-83. This

calculation does not reflect changes in dealer discounts and rebates; inasmuch as rebates have narrowed substantially since March, 1981, the estimate is undoubtedly biased downward.

Finally, one can assess the impact of the VERs by examining the behavior of the Consumer Price Index for new cars since March, 1981. Historically, the CPI for cars has risen less rapidly than the total CPI. Part of the reason for this differential is that the Bureau of Labor Statistics deducts estimated improvements in quality -- including regulatory costs -- from price increases for automobiles. The total adjustment for quality improvements in 1981-83 was nearly $850, of which about $700 reflects regulatory costs. Since most other components of the CPI are not similarly adjusted, the new-car CPI should rise less rapidly than the total index, ceteris paribus.

The new-car component of the CPI increased by only 0.3 percent per year in the 1960s while the CPI as a whole rose by 2.7 percent per year. In the 1970s, the corresponding figures were 5.1 percent and 7.5 percent. But since the inception of import quotas, the difference has narrowed remarkably. From March, 1981 through December, 1983, the new-car component of the CPI increased by 4.5 percent per year and the overall CPI by 4.9 percent. Had the 0.68 ratio of the 1970s persisted, we would have expected the new-car component to advance only 3.3 percent per year during this period -- 1.2 percent less than actually observed. If the prices of domestic cars had risen at this lower annual rate, then, as part 3 of Table 7 indicates, they would have been an average of $368 less than they were.

Equally striking is the behavior of the new-car CPI in the period just after the import quotas were introduced. From April through December, 1981, the new-car CPI increased at a 10.3 percent annual rate, after rising at a 4.1 percent rate for the preceding 14 months. This surge occurred during a continuing decline in demand.

The various calculations just discussed are likely, for three reasons, to underestimate the impact of the quotas. First, they do not take into account the sizable interest rate subsidies that were offered in 1981. Second, the continued appreciation of the dollar and the improvement in the relative quality of Japanese automobiles would have placed relatively more downward pressure on U.S. car prices in 1981-83 than in previous periods. If there had been no quotas, we surely would have expected U.S. car prices to reflect increasing import competition. Finally, wage rates paid by U.S. automobile producers grew somewhat less rapidly than average U.S. wages in 1980-83, after having increased more rapidly in 1975-80. Absent the quotas, these lower wage costs would have been reflected in new car prices.

Profits. As a check on these estimates, one might look at the before-tax profits of the companies. If prices increased abnormally relative to costs, profits should have risen relative to their historical relationship with volume. To test for this outcome, I used the Commerce Department's estimate of domestic profits (before taxes) in the motor vehicle industry, adjusted for changes in inventory valuation. Table 8 shows the very strong recovery in pretax profits since 1980. Despite much lower sales volumes, the real profit per domestic vehicle produced has rebounded to 1978-79 levels. In fact, on the sale of fewer vehicles than were sold in 1975, real

Table 8
Profits Before Taxes*, 1970-83

Year	Before-tax Profits (Billions of $)	Before-tax Profits (Billions of 1972 $)	Before-tax Profits per Vehicle (1972$)
1970	1.2	1.3	160
1971	5.0	5.2	490
1972	5.9	5.9	520
1973	5.7	5.3	423
1974	0.1	0.0	472
1975	1.9	1.5	165
1976	7.2	5.3	461
1977	9.4	6.5	513
1978	8.9	5.7	443
1979	4.7	2.7	235
1980	-3.8	-1.9	-239
1981	-0.6	-0.3	-37
1982	0.9	0.2	27
1983	7.7	3.2	353

* with inventory valuation adjustment

Source: Department of Commerce, Motor Vehicle Manufacturers Association.

profits per vehicle in 1983 were more than double what they had been in that earlier year. When before-tax profits, deflated by the CPI, are fitted to total vehicle sales (including trucks and buses), the import share, a dummy variable for the 1973-74 price controls, and a dummy variable for the 1981-83 period, the results show that profits have risen by 50 percent over 1960-80 levels for the same levels of vehicle production. This translates into $280 per vehicle, including large cars, trucks, and buses. Since import restarints have not raised truck and bus prices and have had less of an impact on the prices of large cars than on those of small cars, the effect per small car must have been substantially greater than $280. These increases in profits may have been due in part to productivity gains, but a substantial share of the explanation must be the price effects of import restraints.

Employment. It is difficult to see how the VERs could have shifted more than 5 to 8 percent of the U.S. market from Japanese imports to U.S. cars in 1981-83. At most, a market share increase of this magnitude might have saved 46,000 jobs in the domestic automobile industry. (The total number of factory workers would have risen by about 7.7% from the 1983 level of 600,000, or about 46,200. The 7.7% figure is based upon a 0.7 elasticity of employment with respect to output.) Unfortunately, the cost of preserving these jobs through trade protection has been extremely high.

What that cost has been depends upon the extent of relative-price effects, welfare losses in production, and welfare losses in consumption caused by constrained consumer choice. Concentrating only on the price effects, if the average price of U.S. cars has risen $400 and the average

price of Japanese imports has gone up $1,000, the cost to consumers in 1983 was $4.3 billion plus additional losses in consumer welfare due to the VERs constraint on the choice of cars. The cost per job saved, therefore, was nearly $100,000 per year. Employment creation at this cost is surely not worth the candle.

It is possible that the number of jobs saved was substantially less than 46,000 and that the per-job cost estimate just presented is overly conservative. Falling gasoline prices and the increasing demand for larger cars should have offset some of the rising pressure on small-car sales caused by a depreciation of the yen against the dollar in 1981-83. An eight percentage point shift in market share translates into an import share of 35.5 percent in 1983 without the quotas. This would have required Japanese imports of 40 percent more than the quota level in 1983. While it is conceivable that Japanese imports would have risen by this much, it seems unlikely; such an increase would have required a very high price elasticity of demand for these cars, little reduction in U.S. auto prices to meet the comeptition, or both. Without the quotas, it is likely that U.S. automobile prices would have been lower, thus restraining the shift to the Japanese models.

Conclusion

As this article is being completed, the Japanese government is beginning to express support for the restraints on automobile exports to the United States. This support has come as a "surprise" to U.S. trade

officials, according to news reports. If the restraints raise the price of Japanese cars in the United States by $1,000 per vehicle or more, the Japanese should be pleased indeed -- unless, of course, a slightly tighter or looser restraint would increase their profits even more.

Given the scant evidence that these quotas are advancing the competitiveness of the U.S. automobile industry, their desirability turns on whether Americans wish to pay large premiums on their cars in order to increase the employment of auto workers at wages far above the manufacturing average. Indeed, because they have produced high profits in the industry, the VERs may actually lead to a widening of this wage differential in the 1984 contract negotiations. If that happens, the political necessity for quotas will increase, and future presidents will have difficulty arguing that the domestic automobile industry should once again face the rigors of international competition.

Senator DANFORTH. I have to say I'm a little confused looking at table 8 of your testimony, Mr. Crandall, on page 24, the last column, which is "Before Tax Profits Per Vehicle in 1972 Dollars."

Mr. CRANDALL. Yes.

Senator DANFORTH. That table indicates that the profit per car in 1983 was $353.

Mr. CRANDALL. That is profits per total vehicles,

Senator DANFORTH. That the profit-per-vehicle was $353, and in the years beginning 1971 and ending in 1978, before the disaster hit the auto industry, every one of those years but one the profit-per-vehicle was significantly higher.

Mr. CRANDALL. Well, remember that 1983 was a very bad year historically for total sales. Automobile sales were down at 6.4 million units. If you go back to 1975, which is a slightly better year, 6.8 million units, they only earned $165 in 1972 dollars. There has been a substantial upward shift in that profit function—that is, historically they would have earned substantially less than that at as low a volume as 6.4 million cars.

Senator DANFORTH. I opened the hearing by saying that 1983 was the year of record profitability, and this would indicate that it was not.

Mr. CRANDALL. Well, it was not in real dollars; 1984 may well be, but not in real dollars. In nominal dollars it was.

Senator DANFORTH. What do you think would happen if the voluntary restraints went off? A lot of people say it would be a flood and about 40 percent of the auto market would be taken over by the Japanese.

Mr. CRANDALL. I don't think the 40-percent number is reasonable. I don't know what the long run holds, but if in fact we were

holding back demand for 40 percent Japanese cars, holding them today at less than 20, the premia which buyers would be paying to scramble for those Nissans and Toyotas I think would be far greater than what we are seeing right now.

My own guess—and this is merely an estimate—is that we may, at outside, have increased the U.S. producers market share by about 8 percentage points relative to the Japanese, and I think that is an outside estimate.

Senator DANFORTH. So that would be up to about, what? thirty percent?

Mr. CRANDALL. It would be in the high 20's yes; around 27, maybe.

Senator DANFORTH. That would still be a real shock to the U.S. auto industry, wouldn't it?

Mr. CRANDALL. Yes, I think it would be. But remember the other point made earlier—if we were to have no quotas, the average price of automobiles would be lower, and the total demand for cars would be higher. One of the things which we have unfortunately done, through a combination of trade restrictions and regulation, is to greatly increase the price of cars in the United States; thereby depressing demand. You see that, as was mentioned, feeding back into the used-car market.

Senator DANFORTH. Well, do you think prices would go down if the quotas went off?

Mr. CRANDALL. Oh, definitely. That is one of the things the Japanese fear the most. If you were to bring Toyota and Nissan to this witness table now and ask them what they fear most about the relaxation of quotas, it would be that their small competitors—the Suzukis, the Isuzus, the Mitsubishis, would begin to increase competition drastically, driving down those huge profit margins which they are now earning on their cars.

Senator DANFORTH. Then let me put this to you: What would be the effect of just cold turkey on the voluntary restraints? Would it be good for the U.S. auto industry? Would it be bad for the U.S. auto industry? Would it be neutral?

Mr. CRANDALL. Well, I think there would be an initial shock. I don't think it would be nearly as large as some of the numbers you have heard. I think in the long run it would be beneficial. It seems to me that the competitive threat from the Japanese would put further pressure on trying to streamline operations in domestic plants and reduce the cost of production in those plants.

Senator DANFORTH. You indicate in your paper that we would have been better off going to tariffs. Does that mean that quotas are even worse than tariffs, or is it to say that we should go from quotas to tariffs?

Mr. CRANDALL. It is certainly true that all other things equal the U.S. consumer and taxpayer is better off with tariffs than quotas. What we do through our prospective steel quotas or through our auto quotas is to confer enormous rents upon foreign suppliers to this market. If we impose tariffs, obviously we capture those rents in the form of tax payments to the U.S. Treasury.

Of course, if we were to go to tariffs rather than to quotas we might find slightly greater opposition abroad to our imposition of trade restrictions, and greater retaliation.

Senator DANFORTH. Well, what is your suggestion?

Mr. CRANDALL. Well, I would like to see us move away from quotas in the automobile industry. I mean, it is a political judgment as to how one does that and at what speed, and that is not a judgment on which I am very expert.

Senator DANFORTH. But, as an economist what would you do?

Mr. CRANDALL. I would think the U.S. economy would be far better off without quotas.

Senator DANFORTH. But how about as an economist with particular concern about the health of the U.S. auto industry; what would you suggest?

Mr. CRANDALL. Well, I don't know that I have necessarily particular concern about the auto industry. One of the interesting things about that——

Senator DANFORTH. But suppose that I were to hire you to be the economist for the U.S. auto industry. [Laughter.]

And I asked what you would suggest?

Mr. CRANDALL. As long as you could assure me that people who make only the average manufacturing wage rather than automobile wages wouldn't listen to my remarks, I think we could make a good case for keeping them for the benefit of autoworkers.

Senator DANFORTH. For keeping them?

Mr. CRANDALL. The quotas, yes. As long as those people who are paying the costs do not listen.

Senator DANFORTH. Senator Matsunaga.

Senator MATSUNAGA. Thank you, Mr. Chairman.

Mr. Crandall, have you made any study as to why Americans prefer foreign cars to American cars?

Mr. CRANDALL. Well, only in the sense that what I have tried to do in one of my approaches to the U.S. cars, to the prices of U.S. cars, is to look at the qualitative attributes of all of these cars and to see how they contribute to the value.

Clearly, one of the reasons why there has been a shift is the perception of improving quality in Japanese cars relative to U.S. cars. The interesting thing is that one does not find much variance in the prices Americans are willing to pay for Japanese cars with differential fuel economy among those cars. The conventional wisdom is that they made their great strides because of an increased price of gasoline and these are more fuel-efficient cars; yet, if that were true one would expect American consumers to pay more, all other things equal, for more fuel-efficient Japanese cars, and I don't see any evidence of that.

Senator MATSUNAGA. Well, I wish you would make a study, maybe interview a thousand owners of American cars, a thousand owners of foreign cars—Japanese and German cars—and maybe you will find that you will be doing a big favor for the American auto industry. I myself, in my lifetime, and I have five kids—they are all through college now—have purchased 19 cars, all American. I have refused to buy foreign cars. But the problems I have had are the same problems my neighbors have had with American cars. I insisted when one of my daughters graduated from college that she buy an American-made car. She wanted to buy a Toyota, and I said, "No, so long as you want me to pay for it, you must buy an American car." So she looked at a Vega. It looked nice at that

time, but that Vega was in the garage 6 months of the first year. And then the same thing with the Phoenix that my younger son bought. I could go on and on.

Senator DANFORTH. If you are asking this of Mr. McElwaine, you are setting him up for a commercial. [Laughter.]

Senator MATSUNAGA. Anyhow, I think we ought to look to improving the quality of American cars. Until about 2 years ago I had bought all GM cars—the last one was a brand new 1983 Celebrity. During the first year it was 15 times in the garage. So I thought I should shift to Chrysler. Chrysler, as you know gives a 5-year 50,000-mile warranty. So I bought a Chrysler E-class car. What happened? The roof leaked. To top it all, there was a rattling sound in the area of the dashboard.

My daughter who owned the Vega approached me one day and said, "Please, Dad, I'm not living with you now. Let me trade my car for a Japanese car." I grudgingly consented, and she bought a Toyota. She was so happy with it; drove it for 3 years; and sold it for about the same price she paid for it. [Laughter.]

My son traded his Pontiac for a Toyota. He is so happy with that Toyota—he has been driving it for a year and has had no problem at all.

You see now, why I think you should make a study of why Americans buy foreign cars. You would be doing a big favor for the American auto industry.

Mr. CRANDALL. Well, I think the U.S. auto industry is fully aware of its quality problems, and what it is doing to its market share. They have done those studies themselves and understand it.

I must admit that our trade policies are going to solve your problems for you, because very soon you will be able to buy a Mazda, a Honda, a Toyota, or a Nissan that has been made in the United States. So maybe you will be a happier man.

Senator MATSUNAGA. Perhaps the American-made Japanese named cars will be just as bad. [Laughter.]

Well, I have more questions of the others, but I see my time is up.

Senator DANFORTH. Do you have other questions?

Senator MATSUNAGA. Well, I was particularly interested in what Mr. McElwaine had to say and, if I may proceed, I would like to ask him whether or not the difference between the $900 profit on the average American car and the $265 profit on the average Japanese car was made necessary in order to pay the big bonuses to U.S. auto executives? If they had not taken the huge bonuses, do you think the price of American cars could have been reduced somewhat to be more competitive?

Mr. MCELWAINE. I am not sure that the price, Senator, would have been affected; but certainly you can see where the future competitiveness of the U.S. industry could have been improved. The bonuses paid to the executives of General Motors alone, for example, came within a few million dollars of equaling the cost of the entire Volkswagen factory in Pennsylvania. That money could have been used for purposes that would have made these corporations more competitive in the future rather than for executive bonuses.

Senator MATSUNAGA. Thank you, Mr. McElwaine. Now, Mr. Healy, your association is opposed to the pending measure in Congress as to American content of import cars, is it not?

Mr. HEALY. Yes; what we are very concerned about is that a lot of people don't understand. In 1960 the cars exported from Japan—a world market—the United States had something like 54 percent of the world car market in 1960. It now has about 24 percent. The Japanese had 1 percent and now has 24. All of those cars are Japanese-made parts. Again, the jobs and the parts on those cars are twice what—everyone talks about the auto manufacture assembler. Twice the number of jobs go to parts, and that's what we are concerned about. If we can't get incentives or eliminate the disincentives to import into Japan and other countries, our parts markets are disappearing. They are drying up around the world. They have taken away the markets in Latin America and all across the world. It is not only here. And all of those 24 percent of the market here which would probably go to more than 30 eventually, for whatever the reasons, most of those parts if not all of them come from Japan. And so all of those batteries, all of those hoses, all of those parts come from overseas. The Japanese will not specify American parts. They block it and continue to block us in things right down to the little spark plugs. It is the old Champion story—it went all over the world except in Japan.

Senator MATSUNAGA. Is yours an international association?

Mr. HEALY. Yes, it is.

Senator MATSUNAGA. Do you have Japanese auto dealers among your membership?

Mr. HEALY. No, we do not.

Senator MATSUNAGA. You do not?

Mr. HEALY. Not that I know of—I don't think so. It really is in parts.

Senator MATSUNAGA. Are you cognizant of the fact that the Japanese auto dealers in Japan have been trying to get the American automakers to make smaller cars, to shift the steering gear from left to right, and that the American automakers have refused to do it so that Japanese automobile dealers are unable to market American cars in Japan?

Mr. HEALY. Well, if somebody told me that I could ship 1 million cars or 500,000 cars into Japan if I shifted the steering wheel from the right to the left or the left to the right, I would be an idiot not to do it. I find it difficult to comprehend.

I know that the people in our association, the parts people, have extreme difficulty. The specifications keep changing, the types of testing keep changing; there are very obvious roadblocks in our way, and I assume they are happening also to the car manufacturers.

Senator MATSUNAGA. Well, one of the most frequent complaints I heard here in 1978 and 1979 was that the Japanese do not permit American cars into Japan. So when I accompanied President Carter to Japan in 1979 to the summit conference on energy, I requested a meeting with the Japanese auto dealers and with the Japanese equivalent of the chamber of commerce. I told them that the biggest complaint against the Japanese was that they wouldn't permit American cars to be sold in Japan. "Now, why don't you

permit American cars into Japan?" I asked. The response was, "Well, Senator, we have been trying to get your American auto makers to shift the steering gear from left to right and to build smalier cars for our smaller, narrower streets; but they absolutely refuse to do it. So we are unable to sell American cars." And I said, "Are you speaking the truth?" He said, "Yes, sir."

So when I came back to Washington, I asked Senator Russell Long, who was then chairman of the Senate Finance Committee, to invite the domestic automakers to appear before this committee, and I asked them if what I had heard in Japan was true. They responded "Yes, it is true." I asked, "Why?" And they replied, "Well, Senator, our market is not in Japan; our market is here in the United States." So why all the hue and cry about the need for retaliatory action against Japan because it does not allow American cars into Japan?

Sometimes, I think, as it was pointed out by Mr. McElwaine, the representations made by domestic automakers not only to the public but also before congressional committees to be scrutinized very carefully. With that, I'll end.

Senator DANFORTH. Gentlemen, thank you very much.

[Whereupon, at 12:41 p.m., the hearing was concluded.]

[The following communications were made a part of the hearing record.]

STATEMENT FILED BY
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE
AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, UAW
BEFORE THE
SENATE COMMITTEE ON FINANCE
SUBCOMMITTEE ON INTERNATIONAL TRADE
HEARINGS ON
THE STATE OF THE U.S. AUTO INDUSTRY

The UAW regrets that it could not appear before this subcommittee on this vital issue. We hope that this statement with its attachment can be entered into the record of the hearing. The attachment covers the views of the UAW on the state of the industry in some detail.

A key aspect about the state of the industry is the massive investment abroad that is planned or considered by the Big Three to supply this country with small cars. GM has plans for new imports equivalent to about ten percent of its sales here. (See page 6 of the attachment for details.) Ford has also made major new commitments for imports while Chrysler has begun importing K cars from Mexico.

Employment in the U.S. auto industry has improved but not recovered since 1982. The major auto companies employ 23 percent fewer production workers than they did in 1978. Employment will drop still further if, as some Administration officials recommend, the U.S. permits imports to flood into this country next year. (See pages 2 through 5 of the attachment for details on employment.) These officials seem more concerned with auto company profits than with the two and a half million jobs directly and indirectly tied to the industry.

As the attached statement makes clear, the UAW believes that domestic auto content legislation is urgently required for the health of the domestic auto industry. It is both pro-investment and pro-competition. Thank you.

Attachment 1

STATEMENT OF
OWEN BIEBER, PRESIDENT
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE
AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, UAW
BEFORE THE
SENATE COMMITTEE ON COMMERCE, SCIENCE & TECHNOLOGY
ON S. 707
THE FAIR PRACTICES AUTOMOTIVE PRODUCTS ACT

MAY 16, 1984

Mr. Chairman, Members of the Committee, I am Owen Bieber, President of the International Union, UAW. I appreciate this opportunity to testify before your Committee on behalf of the UAW, its members and their families about S. 707, the proposed Fair Practices in Automotive Products Act. I am particularly pleased to be here this morning with the distinguished President of the AFL-CIO, my good friend, Lane Kirkland. We urge this Committee and the Congress to proceed swiftly to enact this pro-investment, pro-jobs legislation.

Many people wrongly believe there is no longer a need for S. 707. The news about higher auto sales, profits, and executive bonuses leads them to believe that everyone in the industry is doing fine. Nothing could be further from the truth. The auto companies employ 23 percent fewer production workers than they did a few years ago. What is worse, they threaten to drop even more jobs over the next few years unless the Congress passes this bill. Thus, we foresee that the Depression-level unemployment of many auto communities would continue until 1990 and beyond.

Time is running out. The major auto companies — both foreign and domestic — are now making long-term arrangements to supply the U.S. with a rapidly increasing volume of imported small cars and components.

We believe auto companies with large volume sales here should be investing and creating jobs here. A substantial majority of the American people agree with us. According top polls last year, they supported local content requirements for auto by margins of 57 to 39 (Lou Harris) and 74 to 20 (Garth/Penn Schoen). Editorials by both Business Week and Automotive News have supported the concept of local content

legislation for the U.S. auto industry. (See Appendices A and B). Ichiro Shioji, President of the Japanese Auto Workers, has advocated for several years that Japanese auto companies should make significant investments in countries where they have large markets, notably the U.S.

More Profits Do Not Mean More Jobs

In the current auto recovery, company profits have soared while employment continues to lag far behind the level of a few years ago. Without a change in government policy, the trends for profits and for jobs will diverge even more widely in the years ahead as the U.S. companies bring in imports that displace many more U.S. jobs.

Partial and uneven recovery has taken place in the auto industry. To guage the decline and recovery in employment, sales, and profits, Chart 1 makes comparisons with 1978, the last healthy year for the auto industry. After four years of decline the industry hit bottom in 1982, the industry's worst sales year in two decades.[1] By 1982, hourly jobs had fallen to 66 percent of the 1978 level, sales had dropped to 60 percent, and the companies barely broke even. For 1984, we project hourly employment at 78 percent and sales at 86 percent of their respective 1978 levels. But Wall Street analysts predict that the auto companies this year will double the profits made in 1978.

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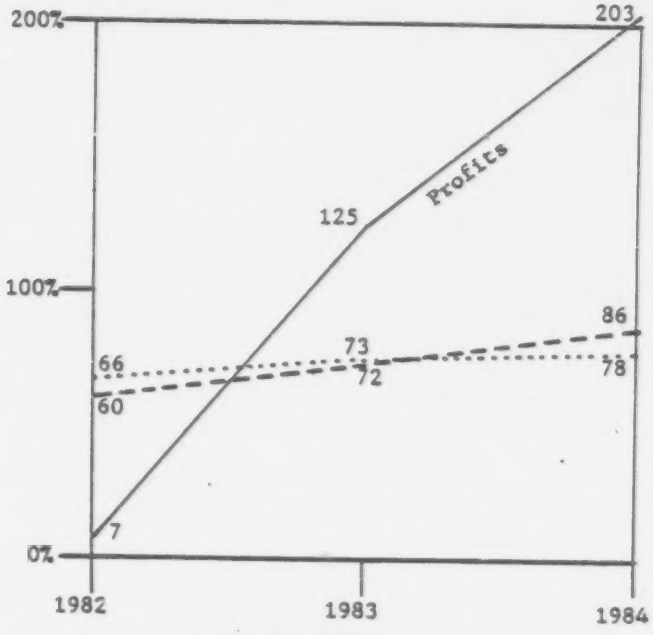
1. Appendices C and D provide details on domestic and imported car and truck sales in recent years and months.

Profits Recover More Than Jobs

(1978 = 100)

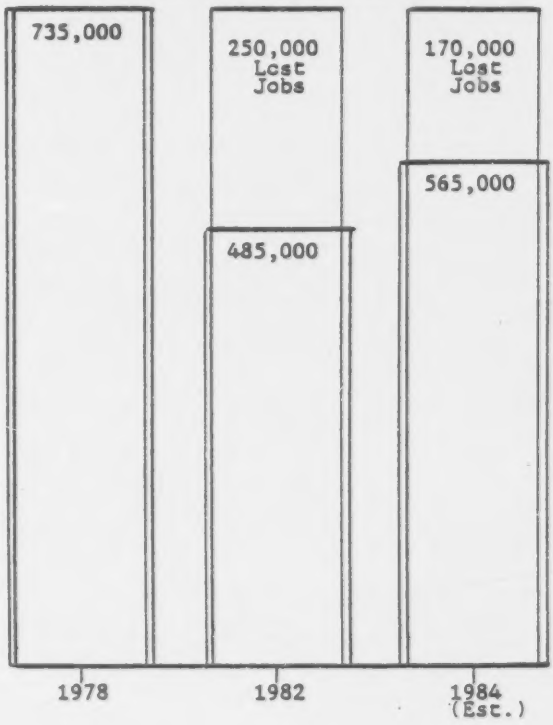
CHART 1



The auto companies today employ 565,000 hourly workers — a reduction of 170,000 jobs since 1978 (See Chart 2). That 23 percent reduction in hourly auto jobs gives a more accurate picture of the employment situation than the 5 or 6 percent "auto unemployment rate" computed by the Bureau of Labor Statistics (BLS). The BLS statistic counts only workers who have not been employed since they lost their auto job and are still looking for work. The BLS does not consider one of the 170,000 workers cut from the company rolls to be an "unemployed auto worker" if (1) she is badly underemployed because, to feed her family, she has taken a low paying job that does not use her skills; (2) she has been forced into unemployment after a stint in any job in any other industry; or (3) she did not look for work within four weeks of the BLS survey, even though she had been job-hunting for years in her community plagued with a double-digit unemployment rate.

CHART 2

Loss of Hourly Jobs at Auto Companies



With the prolonged and very depressed conditions in many auto communities, most former auto workers undoubtedly fit into one of these three categories and would take an auto job if offered. Thus, the BLS statistic cannot guage the severity of the auto unemployment problem because (1) the three above categories are excluded from the BLS measure of unemployed auto workers, and (2) many other older workers have been forced into early retirement. Administration officials persist in using the BLS statistic to dismiss the unemployment problem in the auto industry although we have explained to them how distorted it is on several occasions.

The BLS statistic also cannot reflect the great financial and personal hardships experienced by jobless auto workers. For example, a Cornell University study of the consequences of the closing of a Ford assembly plant in Mahwah, New Jersey found that median income of the 5,000 workers fell more than 50 percent (from $21,600 to $10,400) in the two years after the shutdown.

More recently, a survey in New England of laid-off UAW members which included auto industry workers (conducted jointly by the UAW and the Social Welfare Research Institute at Boston College) found that their average length of joblessness was 34 weeks. Average individual earnings had dropped more than 55% to $151 per week. One-quarter had exhausted all savings and 47% had exhausted half or more of their savings. While previously all had employer-paid health insurance, at the time of the survey nearly one-quarter of our members had no coverage whatsoever. An in-progress survey of unemployed Michigan auto workers suggests even more severe hardships than the New England study.

Research has found a strong relationship between job loss and higher rates of illness and death. Thus, the many jobless workers who lose their health insurance are doing so at a time of rising need for health care protection. A University of Michigan School of Public Health study of unemployed workers in Detroit found two-fifths of the workers had lost employer-paid health insurance when they lost their jobs. Only about one-quarter of these workers were eligible for Medicaid; the others had no health coverage whatsoever. In addition, most had at least one dependent.

Small Car Capacity Threatened

We stand today on the verge of losing most of the capacity to manufacture and assemble small, fuel-efficient autos in the United States. The overwhelming majority of those autos in the near future may be manufactured abroad and sold in this country through the existing dealer networks. If allowed to continue, this trend would by default reverse our past policy to promote local production of such vehicles.

In 1975, in the wake of the first oil crisis, the Congress wisely legislated fuel efficiency standards that have doubled the miles per gallon of the average new car. A key element of that legislation required the U.S. companies to meet the fuel efficiency averages with cars made domestically. As a direct result, when the second oil crisis hit in 1979, the U.S. companies were phasing in substantial new capacity to produce small, fuel-efficient vehicles. For example, U.S. production of subcompact cars rose 66 percent between 1978 and 1983, from 1.2 million to 2.0 million. During those same five years, the U.S. companies sharply curtailed their own imports of subcompact cars. The second oil crisis would have had an even more devastating effect on the industry in the absence of the capacity added due to the 1975 law.

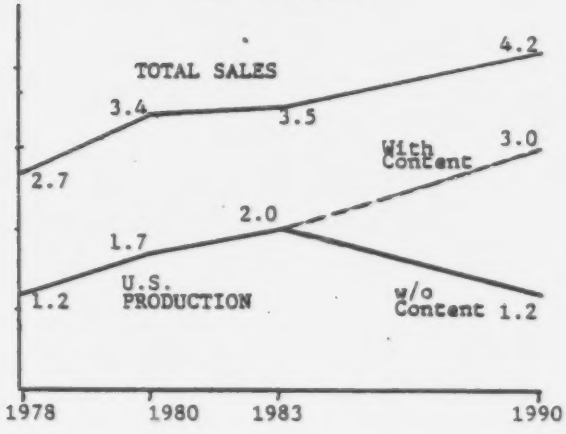
The Big Three have scheduled massive increases in vehicle imports in the next year or so and are considering further imports (See Appendix D). For example, GM has already announced plans for its U.S. dealerships to sell annual imports of 90,000 Suzukis and 200,000 Isuzus from Japan, 60,000 Daewoo cars from Korea, and 200,000 U.S.-assembled cars with 50 percent imported value from Toyota. These 550,000 new subcompact introductions far exceed GM's annual deliveries of Chevettes and T-1000s which GM has made with over 90 percent U.S. content since 1975. In addition, GM will import from Mexico 60,000 vehicles with a truck bed on an intermediate-size car body. Together these new imports would represent roughly ten percent of GM vehicle sales in this country last year.

GM is not alone in making a big turn toward imported vehicles. Ford plans new imports in coming years of at least 160,000 small cars from Mexico and Europe. Chrysler also acknowledges that it is considering a major hike in its imports.

As a result of such developments, U.S. imports of subcompacts could rise from 1.4 million in 1983 to 3.0 million in 1990 if Congress does not enact domestic content legislation. (See Chart 3.) We predict that sales of subcompact cars will number 4.2 million by 1990 by conservatively assuming that 11 million cars will be sold in 1990 and that the subcompact share will remain the same as last year, 38 percent. Yet the current plans of the auto companies leave little assurance that they will build more than 900,000 subcompacts in this country by 1990.

CHART 3

WHERE WILL SUBCOMPACTS BE MADE?
(In Millions)

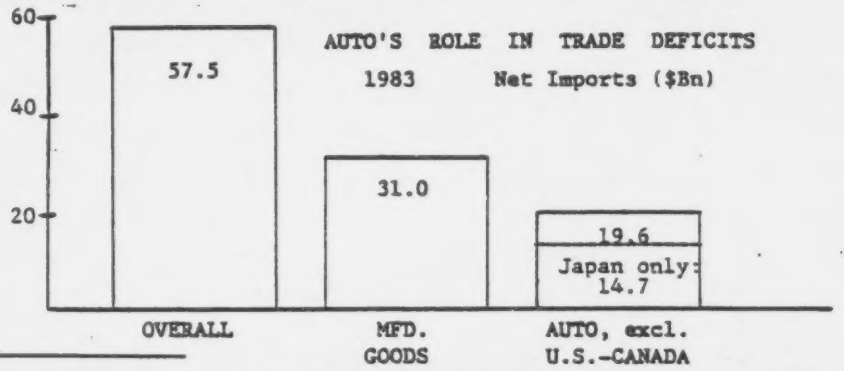


A key point is often overlooked in discussions about the future of small car production in this country: the companies are currently ringing up record profits even as they make almost all of their small cars here. The assumption underlying the 1975 fuel efficiency law has been fulfilled: the auto companies can remain profitable overall even if they make less profit on more fuel efficient cars. The U.S. government should not now permit them to abandon most small car production because the companies expect to make even higher profits with imports.[2] If that is permitted, the U.S. auto industry and the economy as a whole would be even more vulnerable in any future oil crisis.

Strengths of the U.S. Auto Industry Make It a Target

The auto industry's characteristics closely fit the profile of what analysts assume to be America's strengths in terms of technology, R&D, linkages, marketing, and strong local companies. Yet, paradoxically, the auto industry presents the U.S. with its biggest industrial problem by far. As Chart 4 indicates, our trade deficit in auto represented two-thirds of our total deficit in manufactured goods last year and a large portion of the overall trade deficit. The tables in Appendices F, G, and H show that imports of cars and parts have both been growing rapidly.

CHART 4



2. Since some of the U.S. auto companies are falling short of the fuel efficiency standards today, there is some doubt whether they can meet them in the future if they follow through with plans to shift small car production abroad.

The auto industry is a high technology industry. The industry leads other industries in its application of computers for both product design and manufacturing processes. It deploys perhaps a third of the robots now in use in the U.S. Ironically, the automation techniques already standard in auto production have just been introduced in the computer industry at Apple Computer's new Macintosh plant.[3]

Auto spends heavily on research and development. Auto's R&D expenditures as a percentage of sales (4.0 percent) far exceeds the percentages in such successful exporting industries as chemical (2.9 percent), electronics (3.8 percent), and construction and farm machinery (3.3 percent).[4]

The auto industry has synergistic linkages to many other key supplier industries such as machine tools, paints, textiles, steel and other metals, glass, etc. The auto industry has cooperated with these other industries to make many important technological advances that have applications in other industries. Such breakthroughs often could not have been achieved by those supplier industries alone or in cooperation with smaller applications industries.

We have a large internal market that demands the most innovative products. Producers for this market enjoy substantial economies of scale. Our market for subcompact cars alone — 3.5 million last year — far exceeds the total car market in any other single country in the world.

The two largest auto companies in the world are both based here. Last year, GM had U.S. sales of 5.1 million and worldwide sales of 7.8 million while Ford had U.S. sales of 2.5 million and worldwide sales of 4.9 million. Their closest rivals, Toyota and Nissan had worldwide sales of 3.1 million and 2.4 million, respectively.

In theory, these five characteristics should have worked to the advantage of the auto industry here relative to other industries here and to auto industries abroad. In

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3. Infoworld, "The Macintosh Factory: Apple Invests in State-of-the-Art Manufacturing", March 19, 1984.
4. Business Week, June 2, 1983.

practice, they work to its disadvantage. Other governments want an auto industry because of its "high tech," intensive R&D, and synergistic linkages. Our large internal market makes a good export market for others. And the large size of the U.S. companies makes them more prepared to produce abroad.

Auto Policies in Other Countries

The auto industry has played a prominent part in the industrialization schemes of Europe, Japan, and the newly industrializing countries. For decades, they have severely limited auto imports. This not only reduced potential U.S. auto exports but induced U.S. companies to produce abroad. More recently, many of these other countries have promoted auto exports. With every other potential export market relatively closed, the push for exports ends up in the U.S. market.

The auto industry of every country with substantial automotive exports to the U.S. has benefited from the active support of its local government. In studies completed in the last year, the International Trade Commission (ITC) has documented how the governments of Europe and Japan have provided critical and substantial assistance to protect and nurture their domestic auto industries.[5]

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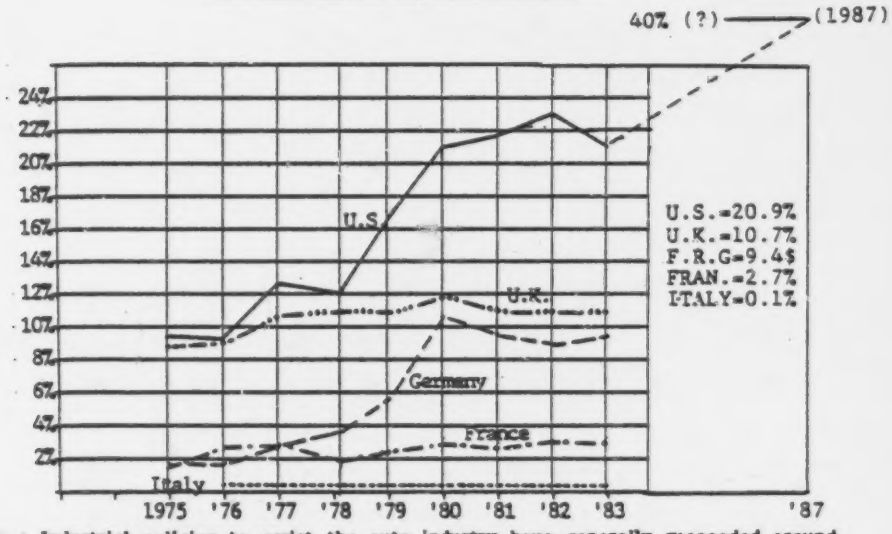
5. International Trade Commission, "Foreign Industrial Targeting and Its Effects on U.S. Industries, Phase I: Japan," October 1983, and "Phase II: The European Community and Member States," April 1984.

Nothing like "free trade" occurs in the auto industry around the world. Over 30 countries have local content laws. Imports comprise less than 1 percent of the Japanese vehicle market. As Chart 5 and Appendix I indicate, the major European countries have kept the Japanese share of their home markets far below the percentage allowed by the U.S. In effect, the major countries of Europe have told the Japanese companies that increases in their market share require substantial investments in local production.

Japanese Share in Major World Markets CHART 5



Industrial policies to assist the auto industry have generally succeeded around the world. As a result, U. S. efforts to convince other countries to stop assisting their auto industries will prove futile. That still leaves us with the problem of what to do about the fact that our industry is rapidly being displaced because we lack an appropriate policy. While the UAW welcomes the fact that a healthy auto industry has contributed to the prosperity of workers in many countries, we believe that our government has responsibility to prevent the policies abroad from spilling over and injuring us.

Lack of Response by the U.S. Government

The U. S. government is effectively discouraging auto production here. We are losing auto investment and jobs while auto industries abroad prosper with government assistance. We not only lack a counter-strategy to retain auto production here, but we permit badly misaligned exchange rates and tax rules on trade to further erode the industry. Despite the unfair and artificial conditions that pose an imminent threat to our auto industry, the U. S. has become the first nation in the world that has failed to defend its industry.

The auto companies often find it more profitable and/or less risky to expand in other countries despite higher real costs of production than here. With fair exchange rates, most countries can compete with the U.S. only with substantial goverment assistance.[6] Japan alone could rival the U.S. industry in terms of true production costs but it also enjoys very sizeable unfair advantages from the yen dollar exchange rate and the tax adjustment rules for international trade.

With the dollar overvalued and the yen undervalued, the two currencies are misaligned by 25 percent or more. The misalignment has the same effect as a 25 percent tax on U. S. production or a 25 percent subsidy on Japanese production for the U. S. market. If the dollar value of the yen went up by 25 percent to where it should be, the cost of a $6,000 Japanese car would rise by $1,500.

In addition, the international trade rules for border tax adjustment are also biased against U.S. auto production. Those rules allow indirect taxes — on which our major competitors tend to rely — to be rebated on exports and charged on imports. The U.S. relies more on direct taxes which are neither rebated for our exports nor charged on competing imports. This means that auto imports from Japan bear few taxes in either Japan or the U.S., but U.S. exports to Japan face substantial taxes in both places. The

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6. According to Ford Chairman Philip Caldwell, true production costs in the U.S. cannot be matched anywhere else in the world except Japan. "The Automobile Crisis and Public Policy: An Interview with Philip Caldwell," Harvard Business Review, January-February, 1981.

argument in economic theory that this distortion will be offset by a lower U.S. exchange rate is clearly nonsensical today.

With its passive policy toward the auto industry, the U.S. industry is inevitably being displaced by production from other parts of the world. Every other major auto-producing center has adopted a combination of policies that assure net auto exports. S. 707 would prevent further rapid erosion of this industry.

Differing Reponses of the U.S. Auto Companies and the UAW

The UAW and the U.S. auto companies do not have the same perspective on the problems of the auto industry here. We are concerned about production and employment here where we live and work. The companies can earn profits whether they supply this market with autos made here or abroad.

The U.S. auto companies have no particular allegiance to production in the U.S. for this market. They already have substantial production facilities abroad and are prepared to produce for this market wherever they find it most profitable. The auto companies tend to resist government interference in their pursuit of profit — whether for purposes of safety or fuel efficiency in other situations or for the sake of U.S. investment and employment in this situation. In a world where government policies are making it more profitable to produce abroad for this market, the U.S. economy and our members will lose out.

As the UAW has tried to make the case for the workers directly and indirectly tied to the auto industry, we have been saddled by the unpopularity of the industry. Over the years, the union has protested early and vociferously about inadequate small cars, huge profits, excessive prices, and outrageous executive bonuses. Because we are often unfairly blamed for these conditions, our job of defending the jobs related to the industry is made more difficult.

The domestic content legislation is pro-investment and pro-competition. By insuring substantial investment, the bill addresses our concern for preventing a rapid erosion of auto related employment. By assuring competition among the major auto companies, it will keep down prices and profits while continuing progress in product and production technology.

How S. 707 Would Work

The provisions of S. 707 are designed to stabilize production in the domestic industry while promoting competition among the auto companies. All companies selling more than 100,000 vehicles a year here[7] would have to achieve a minimum domestic content ratio.[8] The content ratio is based on a company's U.S. auto-related costs as a proportion of its U.S. sales.[9]

The content requirement assigned to a company is based on a smooth upward sloping scale between 100,000 and 900,000 and a flat scale beyond that. After a one year grace period, the requirements would be phased in by equal segments over the next three years. From model year 1987 onward, the content percentage (up to a maximum of 90 percent) is derived by dividing sales by 10,000. Thus sales of 355,000 entail a 35.5 percent content requirement. A "safety net" provision prevents a company from reducing its content ratio by more than 10 percent below the 1983 model year. Thus, AMC/Renault which currently has about 80 percent domestic content could not

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7. In 1983 the 10 auto manufacturers that sold more than 100,000 units supplied over 98 percent of the U.S. market.
8. Contrary to the standard media description, the bill does not "require a certain percentage of American parts in every imported vehicle." The requirements apply only to the largest auto companies and permits those companies to import cars without American parts.
9. Technically, the content requirement is based on a vehicle manufacturer's trade balance in automotive products. For example, a 90 percent content requirement would permit a company to have net automotive imports (imports minus exports) worth up to 10 percent of its wholesale auto sales here. Thus, a company gets credit for all its U.S. costs, including such items as shipping, advertising, taxes, etc. With the content measure based on a company's trade balance, it can be readily calculated by the few companies affected and easily monitored by the U.S. government.

fall below 70 percent. Chart 6 shows the content percentage that would be required for each company from model 1987 onward, if they have the same sales levels as in calendar year 1983. (See Appendix J for assumptions behind this chart.)

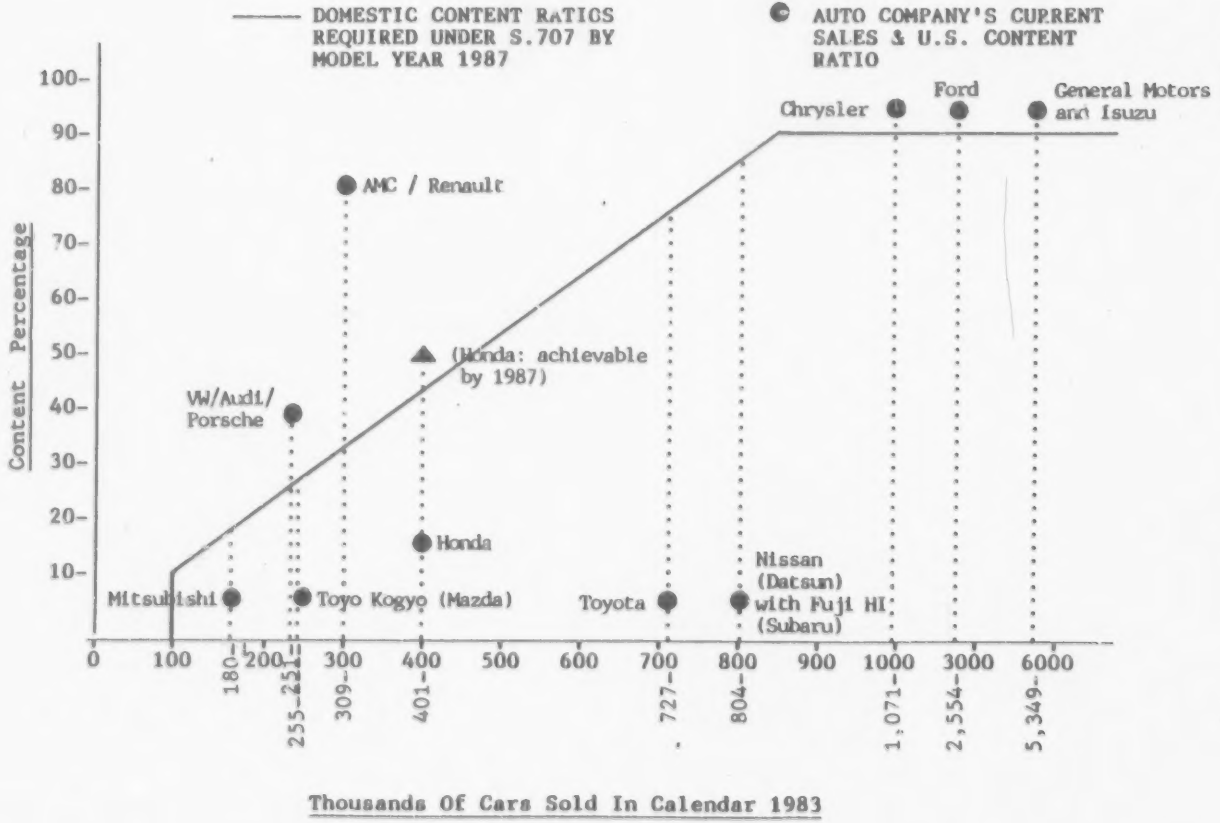
DOMESTIC CONTENT RATIOS REQUIRED UNDER S.707 BY MODEL YEAR 1987
AUTO COMPANY'S CURRENT SALES & U.S. CONTENT RATIO
Content Percentage
100
90
80
70
60
50
40
30
20
10
Chrysler
Ford
General Motors and Isuzu
AMC / Renault
(Honda: achievable by 1987)
VW/Audi/ Porsche
Honda
Nissan (Datsun) with Fuji HI (Subaru)
Mitsubishi
Toyo Kogyo (Mazda)
Toyota
0
100
180
200
255
251
300
309
400
401
500
600
700
727
800
804
900
1000
1,071
3000
2,554
6000
5,349
Thousands Of Cars Sold In Calendar 1983

CHART 6

The Auto Companies Can Comply

Both domestic and foreign-based auto companies have acknowledged that they can comply with the legislation. In practice, the bill would prevent five companies from drastically reducing their production and purchases in the U.S. (GM, Ford, Chrysler, AMC/Renault, and Volkswagen). In addition, it would bring substantially greater domestic production and purchases by five others Toyota, Nissan, Honda, Mitsubishi, and Mazda (Chart 6).

The Big Three U.S. auto companies, GM, Ford, and Chrysler, would each face a 90 percent content requirement. In testimony last year, they stated that their recent operations exceed that level. On the other hand, they are making plans for massive additional imports on parts and vehicles that will not be offset by rising exports (see page 4 and Appendices F and G). Unless this trend is curbed, content at each of the Big Three will soon drop below the 90 percent floor.

The current operations of both AMC-Renault and Volkswagen also puts them well above their respective content requirements (See Chart 6).

With four years to phase in greater domestic operations and purchases, the remaining five companies can maintain their sales levels and competitive pressure. They can move quickly into closed but modern facilities such as VW did in Pennsylvania and Toyota is doing in California. With recent advances in computer-aided production technology, they can assemble quite different vehicles along the same assembly line.[10] U. S. producers can readily supply virtually all parts.

Honda would have little difficulty in meeting the requirements applicable to its recent sales levels. It recently announced plans to expand capacity at its Ohio facilities to assemble 300,000 cars a year by 1986 and to build 60,000 engines there by 1985. In

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10. For example, along the same assembly line in Japan, Toyo Kogyo assembles sports cars and sedans, rear-wheel drive and front-wheel drive vehicles. In addition, Nissan with build cars along with trucks on its current U.S. assembly line.

addition, it will assemble cars in Canada that could readily use parts exported from the U.S. Since the Hondas produced in the U.K. now exceed 60 percent European content without locally made engines, Hondas made in the U. S. can substantially exceed 60 percent domestic content.

The evidence for Nissan also suggests the capacity to increase rapidly its domestic content here. Last week, Nissan announced that it would assemble cars as well as trucks along the assembly line at its new plant in Tennessee. This move had been anticipated since their plant capacity here far exceeds local truck sales and Nissan recently decided to put only a small investment in the U.K.[11] Although Nissan expects to produce 240,000 units annually by 1987, they can actually assemble more on that line, it has adjacent acreage for additional capacity, and it can sharply increase domestic parts production or purchases.

Toyota has contributed the least to the U.S. economy in comparison to what it has taken from it. Its $4 to $5 billion annual exports to this country provide it with ample resources to invest in substantial production and jobs here to supply local Toyota dealers. Toyota has substantially more resources than either Nissan or Honda, both of which have invested independently here to supply their own dealership network.

Since the cars from Toyota's joint venture with GM are scheduled to supply GM dealers, Toyota still has no plans to supply its U.S. dealers with Toyotas made in the U.S. Moreover, the joint venture will be using only one of the two assembly lines previously used by GM at the facility. While we welcome Toyota investment here

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11. In February, Nissan decided it will assemble only 24,000 cars a year in the U.K. These will be included as part of Nissan's U.K. import quota. According to the March issue of the respected Japanese business publication Oriental Economist:

> In order to maintain its No. 1 position in overseas production, Nissan is strongly required to embark upon passenger vehicle production not only in Britain but also in the United States. This is the reason why Nissan has decided to downscale its British project and reserve what financial and other resources it has been left for its U.S. project.

— including the joint venture, substantial additional investment is in order here to supply Toyota dealers.

At this point, Mazda is exploring auto production in the U.S. If it does decide to produce here, its operation should be able to meet the requisite content levels.

Although Mitsubishi is known to be seriously considering U.S. production, it has not yet made a commitment to U.S. production or significant parts purchases. Because of its low sales level, Mitsubishi could readily comply with S. 707.

The latest plans of Toyota, Nissan, Honda, and Mazda prove two critical points about the Japanese auto companies. First, such commitments would not have been made if, as some have worried, these companies had any intention of pulling out of this large, lucrative market. Second, they respond to pressure from the U.S. government. Over the last few years, pressure has come in the form of House passage of domestic auto content legislation and renewed demands for export restraint.

While we welcome their progress, we find that the announced plans of the five major Japanese companies remain very inadequate. They have invested primarily in assembly plants that, in the absence of domestic content legislation, will rely heavily on imported components. As a result, when their plants become fully operational here, the domestic content of all vehicles sold here by the Japanese companies would average roughly 10 percent. S. 707 would raise that average up to roughly 50 percent.

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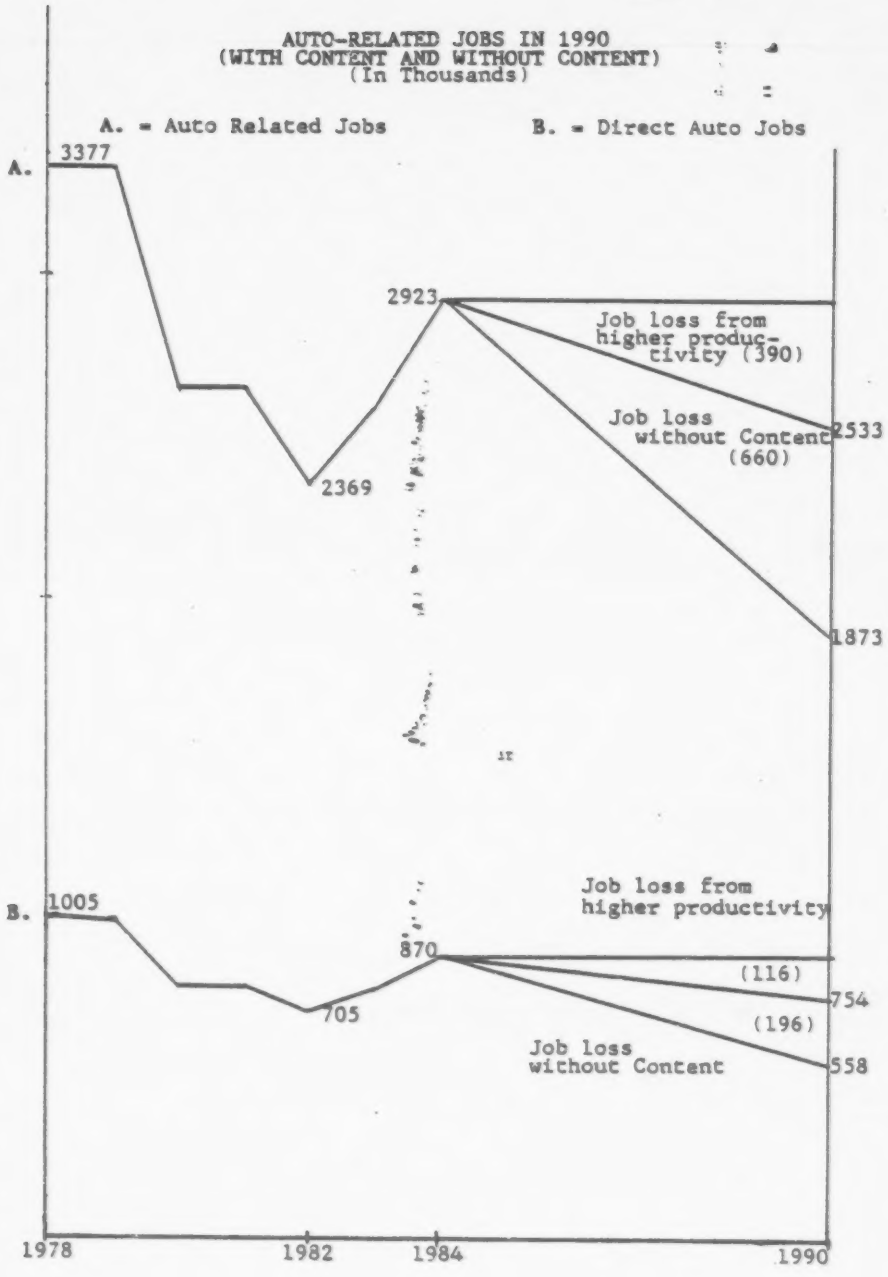
Effect of Domestic Auto Content on Jobs

Enactment of S. 707 would create or preserve over a million jobs by retaining U.S. small car capacity. That includes 660,000 jobs at the auto companies and their suppliers and many more due to the ripple effect in their communities. As Chart 7 indicates, we predict that 390,000 jobs — 13 percent of current jobs — will be lost due to productivity gains over the next six years. On the other hand, without content legislation, we stand to lose a total of 1,050,000 auto-related jobs, fully 36 percent of current jobs. Thus, this legislation would make the difference between serious job losses and catastrophic job losses in auto-related industries.

CHART 7

AUTO-RELATED JOBS IN 1990
(WITH CONTENT AND WITHOUT CONTENT)
(In Thousands)



U.S. automotive production currently amounts to about three-quarters of the value of new cars and trucks sold here. Imported vehicles and parts in excess of U.S. automotive exports account for the remaining quarter of our market. By requiring U.S. production and purchases by all companies with large sales here, this bill would stabilize the future ratio of U.S. production to sales at roughly three-quarters. By the end of the decade, in the absence of the local content law, U.S. automotive production as a share of the market can be expected to fall to about one-half of U.S. auto sales. A fall in U.S. production from three-quarters to one-half of the auto market would eliminate the jobs of more than 196,000 auto workers — and at least 5.5 times that many outside the auto industry[12] for a total of almost 1.3 million jobs.

To stabilize U.S. auto investment and employment relative to the market, the bill compares a company's production here with its sales here. The overall domestic value-added of foreign companies would rise to roughly 50 percent of the value of their sales here, instead of remaining at about 15 percent. In addition, net foreign sourcing by the largest U.S. companies would continue to produce the equivalent of at least 90 percent of their sales here, instead of dropping to an otherwise probable 80 percent by 1990.

Maintaining U.S. production of small, fuel-efficient vehicles and parts will not cost this economy jobs as opponents have alleged. Indeed, one of the two scenarios it considered, the Congressional Budget Office projected a large employment gain.[13] Other opponents have focussed on particular jobs at dealerships in trucking, and on the docks. Employment at dealerships should not be affected if more vehicles are built here rather

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12. According to the economic model developed by the CBO, for every additional job in the auto industry by 1990 there will be a positive ripple effect adding 5.5 more jobs in the rest of the economy — assuming no retaliation, which we consider appropriate for reasons discussed on pages 11-12. The CBO, however, ignores the effect of the bill in curbing the rise of the import share and of foreign sourcing. (See Appendix K.)
13. A critique of the Congressional Budget Office analysis is included as Appendix K.

than imported. In the case of trucking, the number of vehicles shipped to dealers should stay the same but the amount of parts shipped within the U.S. for assembly here would be higher. Finally, auto-related jobs on the docks[14] should be little changed since increased exports and imports of parts should largely offset the effect of lower vehicle imports.

Effect on Consumer Prices, Quality and Choice

Enactment of S. 707 would have a positive effect on the prices, quality, and choice of vehicles available to the American consumer. Studies of the legislation which have projected significant price increases have assumed a major reduction in sales by foreign companies. However, the evidence here and in other countries indicates that the auto companies use every effort to maintain their market. Thus, rather than walk away from this market, all the major auto companies would invest and purchase here in an attempt to maintain and increase their market shares.

The media has widely reported huge auto price increases. In fact, the major reason people are paying more when they buy a new car is that they are buying more car rather than paying higher prices for the same size, accessories, and quality of car. Partly, this is due to the objectionable practice of the companies of loading up cars with mandatory accessories. The BLS computes a price index for new cars by correcting for the upscaling in actual purchases. In the last three years, this price index for new cars has risen a total of 13.3 percent — less than the 15.9 percent increase in the overall Consumer Price Index (see Appendix L). Nonetheless, the level of auto prices is still too high. Their huge profits indicate very successful cost-cutting so that the Big Three can both cut prices and continue to manufacture small cars here. For the future, the auto industry will continue to achieve much higher productivity increases than other industries (See Appendix M). That should help it to keep its price increases below average.

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14. Extrapolating from Toyota's estimates, there are roughly 7,200 jobs in U.S. ports handling imported vehicles.

Consumers are justifiably concerned about product quality. Great strides have been made in improving the quality of U.S.-built vehicles in recent years, proving that high-quality small cars can be produced in the U.S. VW management has said that its Pennsylvania-bred Rabbits are of higher quality than their Wolfsburg, Germany counterparts. Honda says its Ohio-built motorcycles have a lower defect rate than its Japanese or Belgian products. A recent report finds Honda's U.S.-built Accords at least as well-made as the Japanese-made ones. Finally, a study commissioned by one U.S. auto company revealed that its vehicles' quality — as measured by an index of "things gone wrong" — had improved over 50 percent between 1980 and 1983, pulling them ahead of several Japanese import lines to within striking distance of the all import average.

A domestic content law would also retain competition among the world's auto companies to provide the American consumer with a wide variety of innovative products built with the most efficient technologies available. The U.S. producers would continue to be pressured by the discipline of the design, engineering, and managerial innovations of foreign-based manufacturers. S. 707 leaves a company ample flexibility to reduce costs by integrating its U.S. operations into a global production network. Beginning with a graduated four-year phase-in, it must generate production here, but can choose which parts or assembly it wants done here and which vehicles and parts it will import. As a result, the American car buyer should have a wide selection of available vehicles with the best quality and most advanced technology.

GATT, Retaliation, and U.S. Exports

Some critics of S. 707 argue that the legislation is so inconsistent with international norms that its enactment would instigate retaliation against U. S. exports particularly by Japan, and thereby nullify the gains to the auto industry. This fear of retaliation cannot be supported by a careful analysis of auto policies around the world,

the political/diplomatic nature of the General Agreement on Tariffs and Trade (GATT), and Japan's trade patterns.

For a bill that would simply give this country an auto trade policy along the lines of other countries, S. 707 has provoked quite a storm of protest. Critics have called it "the first shot in a trade war" and "another Smoot-Hawley", referring to the 1930 measure that hiked virtually all U.S. tariffs at once. In contrast to the ill-conceived Smoot-Hawley, S. 707 applies to a single industry which, according to all industry experts, stands in jeopardy of serious import injury. Perhaps most importantly, in this case the U.S. would not be firing the first shot but the U.S. would be the last to raise a shield. Finally, it does not isolate the American economy from involvement with other nations, but integrates foreign companies into the U.S. economy over a reasonable four year period.

The House-passed version of domestic auto content, H.R. 1234, calls for disputes to be settled by the rules of international agreements when, like the GATT, they have a procedure for dispute resolution, not by the U.S. courts. As Appendix N explains, the appropriate place to decide whether U.S. legislation raises conflicts with the GATT is through the GATT itself, not in the U.S. courts.

As noted before, the bill affects three U.S. companies, two European companies and five Japanese companies at current sales levels. The American and European companies must shelve plans to bring in a flood of imports. Some, but not all, of the five Japanese companies would have to devote more resources to U.S. production and purchases, than their announced plans indicate.

When other countries have imposed stiff auto restrictions or raised their domestic content levels for auto, Japanese companies have not only complied, they have cooperated. Japan has never lodged a GATT complaint over any of those actions. Most importantly, Japan has continued to increase its trade with those countries. Between 1978 and 1983, Japan increased substantially its imports from every country

with a large auto market severely restricted to Japanese exports, including Australia (up 30 percent), France (40 percent), Italy (21 percent), the U.K. 16 percent), Mexico (282 percent), and Brazil (172 percent).[15]

What would happen if Japan did decide to break all precedent and take formal action against U.S. auto content legislation in the GATT? If, after informal GATT consultations, our two countries fail to iron out difficulties, Japan may ask for a formal legal decision by an impartial panel of experts. At that point, the U.S. would file countercharges against the auto policies of Japan and many other GATT members in Europe, Australia, Latin America, etc.

Thus, before Japan could hope to obtain a recommendation from a GATT panel against U.S. auto content legislation, the U.S. could win rulings against the auto policies of Japan and most other auto-producing countries. Their more stringent restrictions directly injure the U.S. auto industry because they divert Japanese exports to our more open market.

Legal recommendations by a GATT panel have no force, however, until the official representatives of the 88 GATT members ratify them. Given the auto policies around the world, the U.S. would be in a very strong position to defend domestic auto content before that body. Unless that body has the political will to change auto policies around the world dramatically, the U.S. would be justified in keeping its modest domestic auto content law.

Japan can take action against the U.S. only by shooting itself in the foot. It buys from the U.S. only what it cannot make for itself: raw materials and products using technology it does not yet have. For many of these products, the U.S. is Japan's predominant supplier; and for those imports for which Japan does have alternative sources, those source countries have auto policies far more restrictive to Japanese auto

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15. Japan Tariff Association, "The Summary Report: Trade of Japan," issues for 1978 and 1983.

imports than the proposed U.S. legislation: Australia, Argentina, Brazil, Indonesia for foodstuffs and raw materials; European countries for manufactured goods. Japan could retaliate against modest U.S. auto content legislation only by buying less from us and more from countries with auto policies which limit their exports even more severely than would S. 707.

We agree that heightened international economic tensions warrant our concern and that the experience of the 1930s has important parallels and lessons. At that time the U.S. had extremely high real interest rates, the world economy was experiencing volatile exchange rates and general economic decline, and a number of developing nations had to default on their foreign debts. These conditions were primarily responsible for shrinking trade then and are again today. Our international economic distress calls for an international commitment to reflation, repudiation of tight monetary policies, a more orderly exchange rate regime, and expanded credit to countries with a debt-servicing crisis. These, not doctrinaire free trade, were both the policy prescriptions of Keynes after the debacle of the 1930s and the hallmarks of the post-war boom in the international economy.

Constructively Integrating Japanese Industry into the World Economy

The integration of Japan into the world economy on an amicable basis presents one of the most difficult problems in the years ahead. Japanese investment in our industry as envisioned by S. 707 would promote such integration.

Japan has a powerful and yet unbalanced economy. Only a very narrow sector of that economy has competitive product and production technology and is responsible for its exports. The rest of the economy — in services, agriculture, and other manufacturing — has relatively low productivity.

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On the import side, Japan has a relatively closed economy although it may not appear that way in official laws and regulations. Japan's imports are nonetheless very effectively limited without such official public measures.

In the case of official restrictions, the recent negotiations on beef and citrus exemplify the Japanese determination to prevent imports from injuring its industries. The Japanese government projects local beef production will climb almost 5 percent a year over the next four years and intends to allow imports to rise 6 percent a year. Imports from the U.S. will increase from 6 percent to 8 percent of the Japanese market only because the import share from other countries will shrink. Similarly for oranges, Japan agreed to increase imports from the U.S. (virtually its sole source of imported oranges) so that the U.S. share of the Japanese market should rise from 3 percent to 5 percent over four years. According to the May issue of the Oriental Economist, the additional U.S. exports over the four years "translate to about the equivalent of one hamburger per Japanese per year increase, five or six additional oranges, and a few glasses of orange juice."

On the export side, the Japanese government has worked with its manufacturing industries to become competitive exporters in the most rapidly growing sectors. Automobiles and steel fit that bill at one time and have received substantial government support. More recently, the Japanese government's vigorous support has focussed on electronics, telecommunications, and aerospace.

The Japanese government has used credit allocation, import restrictions, subsidies, corporate restructuring, etc. to assist civilian industries in achieving technological parity and large scale production. To one degree or another, the successful Japanese export industries — including auto — have benefitted from such "targeting" measures. These measures can be dismantled once a Japanese industry gets revved up to compete successfully in export markets.

The Japanese export sector has also benefitted from the key resources and skilled manpower (especially government spending, engineers, electronics and computer

specialists, and skilled craftsmen) that are more available to it in part because Japan devotes a much lower percentage of its economy to defense than does the U.S.

Japanese targeting and the undervalued yen have sped the internal development of the Japanese economy and raised their standard of living. If the effects were confined to Japan, we would not complain. The unfairness of the situation arises from the Japanese export drives, coupled with a passive U.S. trade policy, which have rapidly displaced American industries and jobs.

Japan's booming exports and lagging imports are creating huge trade surpluses. Those trade surpluses comprise the bulk of the $31.5 billion current account surplus that the OECD projects for Japan this year. Taking the period 1983 through 1990, the Industrial Bank of Japan projects that Japan will accumulate a trade surplus of $400 billion. Thus, Japan threatens trade disruption and financial "recycling" problems comparable to those caused ty the oil exporters twice in the last decade. It also indicates a permanently "undervalued" yen for trade purposes.

Japanese companies should reduce future trade surpluses by converting some of their export earnings into foreign investment. The auto industry offers a case in point. Over the seven year period 1980 to 1986, Japanese auto companies can expect to enjoy sales exceeding $100 billion in our market. Yet their announced investments here cumulate to less than 2 percent of those sales during the same period.

Thus, enactment of S. 707 would offer a constructive approach to reducing the soaring Japanese surpluses and injurious exports in this key sector. In addition, enactment of S. 707 would put Japanese economic policy-makers on notice that they can no longer expect U.S. passivity when Japanese industry adds substantial capacity with the potential to displace hundreds of thousands of U.S. jobs. For the future, they would be more careful that their new growth industries do not inflict such injury to workers in the counterpart U.S. industry.

Conclusion

The auto industry stands at a crossroads. If the government fails to act, the auto companies will reverse the progress made in creating U.S. capacity for small, fuel-efficient vehicles. The U.S. companies, particularly GM, are planning to supply their U.S. dealer networks with a vastly growing supply of vehicles and parts from their facilities abroad. If the government permits those plans to be carried out, the U.S. economy and its workers will suffer but not company profits or executive bonuses.

Too often our government intervenes to assist the profits of American business rather than the jobs of American workers when serious problems crop up in the international marketplace. For example, our government has vigorously defended the interests of the U.S. banks during recent Third World debt negotiations, at the expense of U.S. exports and jobs. When manufacturing industries have been granted import relief, they have been permitted to shift their investments out of the industry. Steel companies have taken revenues from sales rescued from import displacement and invested them outside of steel production.

When the U.S. government obtained export restraints from Japan and when the UAW renegotiated its contracts early in 1982 (at a cumulative cost of $8,000 per worker during the two and a half year contract), our understanding was that the auto companies would put additional resources into making more competitive small cars here. Despite their high profits, there is scant evidence that they have devoted more resources to small car production here. The auto companies have stayed in auto production, but invested more and more outside the country.

The time has come for the U.S. government to decide that it will maintain a competitive auto industry. That decision would bring the U.S. into conformity with the pattern of auto policies around the world. That policy is supported by a wide majority of the American people.

This country needs expansionary monetary, fiscal, and industrial policies to address the serious problems of its industries. Carefully constructed trade measures must play a part. Enactment of S. 707 would prevent further massive erosion of U.S. auto-related jobs. It could curb the alarming rise in foreign sourcing by U.S. companies, while inducing foreign-based companies to invest and compete here. Because of the magnitude of the industry and the ripple effect on suppliers and spending, the bill would create and preserve well over a million additional jobs in the U.S. economy by 1990.

Mr. Chairman, we thank you for this opportunity to testify on behalf of the UAW in support of the proposed Fair Practices in Automotive Products Act. We urge members of this Committee and the Senate to support S. 707. Thank you.

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APPENDICES

A	Business Week editorial backing local content
B	Automotive News editorial backing local content
C	Auto Sales in 1983
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F	Big Three Foreign Sourcing Arrangements for Vehicles
G	Foreign Sourcing Arrangements for Automotive Parts
H	Automotive Trade Statistics
I	Treatment of Japan by Other Major Auto-Producing Countries
J	Notes to Accompany Chart 6
K	Rights and Wrongs in the CBO Analysis of Auto Content
L	Auto Price Hikes Trail Inflation
M	U.S. Auto Industry Shows High Productivity Growth
N	GATT Questions Should be Resolved within the GATT Framework

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APPENDIX A

A better way to handle auto imports

The U. S. automobile industry can make a strong case for some sort of protection against Japanese imports while it retools to serve the small-car market. But instead of slapping a tariff on Japanese cars or negotiating import quotas, Washington should consider a device that is rarely mentioned: requiring imported autos to contain a specified percentage of parts made in the U. S.

One big advantage of this approach is that it would create jobs in the U. S. auto centers without shutting off the profits of Japanese companies or making it impossible for U. S. consumers to buy the kind of car they want. And whereas a tariff would involve the threat of retaliation and a negotiated quota would call for some sort of quid pro quo, a local content requirement would cause a minimum of disruption in ordinary channels of trade.

Another point in favor of the requirement is that it would leave the free market to decide which U. S. suppliers got the Japanese parts business. Hot competitive bidding would put a premium on efficiency and reliability of products. The requirement, therefore, would not provide a shelter for incompetent, high-cost operations—as a tariff would. And it would not protect companies that yielded to union pressure and conceded overgenerous wage and benefit increases. The competing company that held the line on labor costs would be able to carry off the business.

Practically every industrial nation in the world—except the U. S.—has imposed a local content requirement on imports for years. Detroit, of course, would rather have the comfortable protection of tariffs or a quota. But a local content requirement could help the U. S. economy without touching off a trade war.

BUSINESS WEEK, April 13, 1981.

APPENDIX B

editorial opinion

End the hysteria

Heated debate over the future of imported cars in this market erupted during the recent NADA convention and quickly came to dominate the New Orleans sessions. A great amount of heat and not much light was generated.

Sentiment runs from one extreme to the other: All the way from keeping the market totally free to slamming the door. The stands taken seem largely emotional, based on gut reaction. We think it is time to end the hysteria.

Before it is too late, and before action is taken that is ill advised and could be sincerely regretted later, some sensible decisions must be made.

Now is the time to begin rational debate, aimed toward reaching an equitable decision on import participation.

We still believe that the AUTOMOTIVE NEWS proposal, set forth here a week ago, could well be used as a benchmark. To recap briefly, we think any non-North American automobile should be able to enter the U. S. with no restrictions so long as its volume does not exceed 50,000 units a year. But for each additional 50,000, local content on the total number of cars should be 5 percent. If an auto importer sold 50,001 cars, his cars would have 5 percent local content. If he sold 100,001 cars, his local content would go up another 5 percentage points to a total of 10 percent, and so on. The local-content requirement would reach a maximum of 50 percent when annual sales reached 500,001.

Such a program, we believe, could be implemented immediately, with one-fifth of the appropriate percentage applied right away and increased over the next five years until it reached the proper amount required by sales volume. This would give importers enough lead time to reach the required local content.

We would much prefer that all of the imports would accept this formula voluntarily or, at the very least, work from this as a benchmark.

What we fear is that the government will become involved and produce a complex "solution" that will turn out to be a problem all its own.

If what surfaced at the NADA convention is any indication of what lies ahead, there is going to be too much bothleadedness involved in sorting out the situation. We saw a lot of this—on both sides—at the NADA convention.

The issue must be defused and an equitable solution must be reached. There is not much time left.

AUTOMOTIVE NEWS, February 18, 1980.

APPENDIX C

1983: The Over-rated Auto Sales Recovery

In calendar 1983:

- Domestic car sales totalled 6.8 million units, 18% above 1982's 5.8 million but 26% behind 1978's 9.2 million rate.
- Imported cars were up 7% from 1982, but their share fell from 28% to 26%. The Japanese share was 21%, versus 23% in 1982 but only 12% in 1978.
- Overall, sales of new domestic cars and trucks recovered only 1.51 million units (or 29%) of the 5.17 million-unit 1978-82 sales drop.

Calendar Year Sales and Shares in the U.S. Automotive Market

	1983	1982	1978	Change 83/82	Change 83/78
Domestic Cars	6,795,302	5,756,658	9,159,815	+18.0%	-25.8%
Imported Cars	2,385,613 (26.0%)	2,222,214 (27.9%)	1,999,915 (17.9%)	+ 7.4	+19.3
Japan	1,915,623 (20.9%)	1,801,481 (22.6%)	1,355,886 (12.1%)	+ 6.3	+41.3
Europe	469,990 (5.1%)	420,733 (5.3%)	644,029 (5.8%)	+11.6	-27.0
Total cars	9,180,915	7,978,872	11,159,730	+15.1	-17.7
Domestic Trucks	2,624,071	2,151,768	3,920,983	+21.9	-33.1
Japanese Trucks	463,515 (15.0%)	407,450 (15.9%)	334,918 (7.9%)	+10.2	+38.4
Total Trucks	3,087,586	2,559,218	4,255,901	+20.6	-27.4
Domestic Total	9,419,370	7,908,426	13,080,798	+19.1	-28.0
Imported Total	2,849,128	2,629,664	2,334,833	+ 8.4	+22.0
Japan	2,379,138	2,208,931	1,690,804	+ 7.7	+40.7

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APPENDIX D

THE AUTO INDUSTRY

Sales of domestic new cars have been running at an annual rate of roughly 8 million and they are expected to remain at that rate for the rest of the year. Sales in the first four months come 5.5% short of sales in the same four months of 1978. However, in 1978, sales took off after April and totalled 9.2 million for that year. Domestic truck sales are also running deceptively close to 1978 levels. As in cars, sales of trucks really took off starting in May of 1978 but they are not expected to do so this year.

It is striking that U.S. car and truck output in the first three months of 1984 trailed 1978's first quarter by only 6%, yet there were 170,000 — or 23% — fewer hourly auto workers than in 1978. Moreover, since production in the U.S. in the January-April period was at an annual rate of 12.6 million vehicles, compared to expected 1984 full year sales of only 11.3 million, some decline in employment is likely in the months ahead, as output settles down to being more in line with sales.

The voluntary restraints on Japanese car imports are clearly binding, at long last. So far in 1984, the import share stands at 22%, still well above its 18.8% 1978 share, but down significantly from the 26-28% range that prevailed in 1980-83.

January-April Retail Auto Sales and Employment in the U.S.

	1984		1983		1978		Change 84/83	Change 84/78
Domestic cars	2,715,700		2,036,837		2,873,780		+33.3%	- 5.5%
Japanese Cars	575,018	(16.5%)	624,913	(22.2%)	451,175	(12.7%)	- 8.0	+27.5
European Cars	188,782		147,387		214,529		+28.1	-12.0
Imported Cars	763,800	(22.0%)	772,300	(27.5%)	665,704	(18.8%)	- 1.1	+14.7
Total Cars	3,479,500		2,809,137		3,539,484		+23.9	- 1.7
Domestic Trucks	1,150,340		788,019		1,247,737		+46.0	- 7.8
Japanese Trucks	182,981	(13.7%)	130,420	(14.2%)	101,529	(7.5%)	+40.3	+80.2
Total Trucks	1,333,321		918,439		1,349,266		+45.2	- 1.2
Total Domestic	3,866,040		2,824,856		4,121,517		+36.9	- 6.2
Total Imported	946,781		902,720		767,233		+ 4.9	+23.4
Total Japan	757,999		755,333		552,704		+ 0.4	+37.1
Grand Total Sales	4,812,821		3,727,576		4,888,750		+29.1	- 1.6
Hourly employment at U.S. auto companies, including VW, Nissan & Honda (March):	565,000		481,400		735,000		+83,600	-170,000

APPENDIX E

Major (over 500 Jobs) Big Three U.S. Automotive Plant Closings

Nineteen Big Three plants remain closed (many more are being operated on a sharply lower-volume basis); only two (Fremont and Pico Rivera, the latter in a new industry) are currently scheduled to reopen. However, of the other seventeen all but two could be reopened. Of the fifteen reuseable plants, three are at present configured for car/truck assembly and twelve for stamping, casting, or component manufacture.

	Jobs*	Status as of May 1984
CHRYSLER		
Hamtramck, Michigan	5,600	Demolished
Lynch Road, Detroit	5,000	Stripped
Warren, Michigan (RVs)	2,000	Mothballed
Detroit, Universal, Detroit	1,100	Mothballed
Lyons Trim, Michigan	700	Mothballed
Scio Electronics, Michigan	600	Mothballed
Cape Canaveral Electronics, Florida	500	Mothballed
Huber Avenue, Detroit	2,400	Mothballed
Fostoria Iron, Ohio	700	Mothballed
Vernor Tool and Die, Detroit	700	Mothballed
FORD		
Mahwah, New Jersey	4,800	Mothballed
San Jose, California	4,100	Mothballed
Los Angeles (Pico Rivera), California	2,300	Sold
Flat Rock, Michigan	5,000	Mothballed
Aluminum Casting, Sheffield, Alabama	1,100	Mothballed
GM		
Coit Road Stamping, Cleveland	2,800	Mothballed
Fremont, California	2,600	Will reopen
South Gate, California	2,600	Mothballed
Conner Avenue Stamping, Detroit	1,200	Mothballed

In addition, 250-300 auto supplier plants have been closed over the last several years and about 3,500 dealerships have closed their doors.

* At time closing announced. Past employment was often much higher.

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APPENDIX F

BIG THREE VEHICLE SOURCING DEALS

	Type of Deal	Type of Vehicles	Approx. Number of Units	
1983 CAPTIVES				
GM (Isuzu)	Import	Small vehicles	16,000	
Ford (Toyo Kogyo)	Import	Small vehicles	6,000	
Chrysler (Mitsubishi)	Import	Small vehicles	138,000	
PLANNED: CONFIRMED				**To Begin**
GM - Isuzu	Import	Medium truck	1,000	1984
GM - Isuzu	Import	Small car	200,000	1984
GM - Suzuki	Import	Small car	100,000	1984
GM - Toyota	Joint venture	Small car	200,000	1985
GM - GM de Mexico	Import	Car pickup	30,000	1984
Ford - Toyo Kogyo	Import	Small car (Mexico)	130,000	1986
Ford - Ford of Europe	Import	Midsize car	60,000	1986
RUMORED IN-THE-WORKS*				
GM - Daewoo	Import	Small car	100,000	1987
Chrysler - Mitsubishi	Joint venture	Small car	200,000	1987
Chrysler - Hyundai and/or Daewoo	Import	Small car	100,000	1987

* Also rumored is a U.S. Toyo Kogyo assembly plant — Ford's Flat Rock, Michigan facility is often mentioned — producing 260,000 units per year by 1987, half for Mazda dealers and half for Ford dealers.

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APPENDIX G

FOREIGN SOURCING

Partial List of Known Commitments By Major U.S. Automobile Manufacturers to Purchase Foreign-Made Major Components For Use in Domestic Nameplate Vehicles

	Component	Source	Approximate Number	Delivery Beginning
GM	2.8 liter 6 cyl	GM de Mexico	400,000/year	1982
	2.0 liter 4 cyl with transmission	Isuzu (Japan)	100,000/year	1981
	1.8 liter diesel 4 cyl	Isuzu	Small numbers	1981
	1.3 diesel 4 cyl	Isuzu	N.A.	1983
	1.8 liter 4 cyl	GM de Brazil	250,000/year	1979
	THM 180 Automatic transmission	GM Strasburg (France)	250,000/year	1979
	Manual transmissions	Isuzu	200,000/year	1981
Ford	2.2 liter 4 cyl	Ford-Mexico	400,000/year	1983
	Diesel	Toyo Kogyo (Japan)	Small numbers	1983
	2.0 liter 4 cyl	Toyo Kogyo	100,000/year	1982
	2.3 liter 4 cyl	Ford de Brazil	50,000/year	1979
	2.3 liter 4 cyl	Ford-Mexico	N.A.	1984
	Manual & automatic transaxles	Toyo Kogyo	500,000/year	1980
	Aluminum cylinder heads	Europe, Mexico	N.A.	1980
	Accessory Motors	Ford-Singapore	N.A.	1984
	Electronic Engine control devices	Tashiba	100,000/year	1978
	Ball Joints	Musashi Seimibu	1,000,000/year	1980
	C3 transmissions	Ford-France	75,000/year	1982
	Hummer transmissions	Ford-Germany	18,000/year	1979
	Tremec transmissions	Mexico	96,000/year	1971
	Trim and windshields	Mexico	More and more	1982
Chrysler	6 and 8 cyl engines	Chrysler de Mexico	100,000/year	1982
	2.2 liter 4 cyl	Chrysler de Mexico	200,000/year	1981
	2.6 liter 4 cyl	Mitsubishi (Japan)	200,000/year	1981
	CV joints	Mitsubishi	N.A.	1983
	AC compressors	Mitsubishi	N.A.	1982
	Wiring harnesses	Chrysler de Mexico	N.A.	1983
AMC	Car components and power train	Renault in France and Mexico	250,000/year	1982
VWA	Radiators, stampings Rabbit	VW de Mexico	100,000/year	1979
	4 cyl engines	VW de Mexico	Small numbers	1982

N.A. = Figures not available

APPENDIX H

Automotive Trade (excluding Canada), by Type of Product
($ million)

		1964	1968*	1973	1978	1980	1982	1983
Total**	Exports	2,383	1,283	1,892	5,262	7,092	7,100	4,921
	Imports	712	1,807	5,449	14,731	19,464	20,853	25,271
	Balance	1,671	-524	-3,557	-9,469	-12,371	-13,753	-20,350
Passenger Autos	Exports	270	118	215	956	884	517	386
	Imports	560	1,433	3,716	9,583	12,877	14,392	17,067
	Balance	-291	-1,315	-3,501	-8,627	-11,993	-13,875	-16,681
Trucks & Truck Tractors	Exports	372	170	203	920	1,143	1,264	754
	Imports	7	3	276	1,225	1,830	1,495	1,764
	Balance	366	167	-73	-305	-687	-232	-1,010
Motor Vehicle Parts	Exports	1,653	858	1,246	2,484	3,883	4,259	3,323
	Imports	123	329	1,376	3,768	4,573	4,587	6,028
	Balance	1,530	529	-130	-1,284	-690	-328	-2,705

* first year of a deficit in overall auto trade
** total includes buses, special purpose vehicles and snowmobiles in addition to passenger cars, trucks and parts

Source: International Trade Commission

Notes: Due to rounding, figures may not add or subtract as shown

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APPENDIX I

Treatment of Japan by Other Major Auto-Producing Countries

	Local Content By Law	Local Content In Practice	Local Production of Japanese Cars and Trucks	Tariff	Treatment of Japan
Australia	Yes		Yes	35-57%	
Belgium				10.8%[3]	Japan's voluntary export restraint (VER) holds its share to 20% of Belgium market.
Brazil	Yes		Yes	185-205%	
Canada					VER around 20%
France		Yes[2]		10.8%[3]	Customs prevents entry of more than 3% of French market.
Germany				10.8%	VER at 10% of market
Italy		Yes[2]	Yes	10.8%[3]	Official quota of 2,200 Japanese cars
Mexico	Yes		Yes		
Spain	Yes		Yes	68%	
U.K.		Yes[1]	Yes	10.8%[3]	VER at 10-11%
U.S.A.			Yes	2.7%	VER around 20%

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1 While holding Japanese companies to less than 11 percent of their market, the U.K. has negotiated for government-owned BL, Ltd. to build Honda Acclaims under license. According to Nissan, pressure from U.K. Prime Minister Thatcher led to its decision in early 1984 to assemble 24,000 cars a year there - all to be counted against Nissan's U.K. import quota.

2 France and Italy stopped treating British-assembled Hondas as Japanese imports subject to their stiff quotas only after they achieved the 60 percent European content sufficient for treatment as an EC product.

3 Value-added taxes applied to tariffs raise their effective rate to 13-14 percent.

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APPENDIX J

Notes to Accompany Chart 6

- It is estimated that the U.S. "Big Three" have about 95% domestic content.
- AMC/Renault now has about 80% domestic content.
- Volkswagen says that it has about 70% domestic content in their "Rabbit" line made here today and 40% domestic content after its imports are averaged in.
- Foreign companies without production here already have 6% content on the basis of their expenses here, e.g., sales staff, freight, advertising, and property taxes.
- Honda has an Ohio plant moving toward 50% U.S. parts with just a one shift operation. Honda produces a third of its U.S. sales here, raising its content ratio by 17 points to 23 percent. Honda plans to build nearly 300,000 cars a year in Ohio by 1986. If those cars have, say, 60% domestic content, they will raise Honda's overall U.S. content to 50% — 6% non-production expenses, plus 44% (i.e., 60% of 300,000 as a share of its total 1983 U.S. sales of 401,000) — which would exceed the 40% needed for compliance at 1983 sales levels.
- Nissan (maker of Datsuns) plans to produce 240,000 cars and trucks in Tennessee, or about one-third of its level of sales last year. If those have 60% domestic content by 1987, that whould raise Nissan's U.S. content 20 points.

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APPENDIX K

Rights and Wrongs in the CBO Analysis of Auto Content

The economic analysis of domestic auto content done by the Congressional Budget Office[1] (CBO) supports the UAW conclusion that it would make the difference of over one million jobs in the U.S. economy by 1990. The second and more plausible of the two scenarios studied by the CBO found an earlier version of the legislation would result in a substantial U.S. jobs gain by 1990: 520,000, of which 80,000 would be in the auto industry. However, three naive assumptions that made the CBO's job estimate come in on the low side.

Naive Assumption #1: Share of imported vehicles would not rise in any case

CBO understates the job impact of content by assuming that imports would comprise only 25 percent of the U.S. market in the absence of the legislation. Most auto industry experts at the time and since have projected far higher import shares for the U.S. in the absence of government action. For example, the industry experts at the Department of Commerce predicted imports in the 35 to 40 percent range by the end of the decade.[2]

Naive Assumption #2: Bill would not reduce imports of auto parts

CBO also underestimated the positive job effect of content by failing to consider the restraint on auto parts imports and/or stimulus to export parts. Every survey of auto company executives and outside industry experts predicts a massive increase in such imports if the U.S. government fails to act. With net imports of both parts and vehicles counted together, the U.S. companies would surely bring in more than ten percent of their U.S. sales in coming years. Yet the CBO job estimates fails to consider the beneficial constraint that content legislation puts on those imports.

Naive Assumption #3: Foreign auto companies would invest little here

The CBO assumed that foreign auto companies would not make substantial investments here in an attempt to maintain their sales levels here. They assumed that those companies would buy a few parts here and accept a ceiling of 250,000 on their sales here. They concluded that neither Toyota nor Nissan would build vehicles here, oblivious to the fact that Nissan was nearing completion of its full-scale assembly plant here and Toyota's talks with GM had begun. While the CBO believed that no foreign company would build engines here, Honda has announced that it will do just that next year.

The CBO has often been cited for its other scenario that predicted a slight negative effect on jobs. However, this scenario entailed total retaliation against U.S. exports by countries whose exports had been limited. The companies faced with the most difficulty in meeting the content levels while maintaining sales here are based in Japan. When other countries have imposed limits and conditions on the import sales of those companies, they have complied and Japan has not retaliated. In fact, Japan's imports from those countries has continued to grow.

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1. CBO, "The Fair Practices in Automotive Products Act (H.R. 5133): An Economic Assessment" and revised summary analysis submitted to the House Ways and Means Subcommittee on Trade, September 23, 1982.
2. U.S. Industrial Outlook 1983.

APPENDIX L

Auto Price Hikes Trail Inflation

Despite repeated statements to the contrary, when rebates and quality changes are taken into account and when considering a constant mix according to size and other characteristics, **since 1978 price hikes for both domestic and imported cars have been extremely moderate,** consistently below overall inflation. This has been particularly true in the case of small cars: the restraints have been accompanied by increased small car competition among domestic producers.

		Change in CPI-U	
		New Cars	All Items
	3/78 - 3/79	7.6%	10.3%
	3/79 - 3/80	8.0	14.6
	3/80 - 3/81	4.2	10.5
(1st restraint year)	3/81 - 3/82	6.3	6.8
(2nd restraint year)	3/82 - 3/83	3.5	3.6
(3rd restraint year)	3/83 - 3/84	3.0	4.7
(Since restraints)	3/81 - 3/84	13.3	15.9

This is not to say that the U.S. companies shouldn't exercise price restraint and even cut prices on some models. Their high profits and the incomplete sales recovery both suggest they should.

Allegations that enactment of S. 707 would send prices soaring are based on the erroneous assumption that the law would function as a tight, rigid quota, rather than a flexible inducement to compete with more investment.

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APPENDIX M

U.S. Auto Industry Shows High Productivity Growth

Productivity growth in the auto industry has proceeded at a healthy 3.5 percent clip since the late '50s, sustantially higher than the 2.7 percent rate attained by the overall manufacturing sector. This is in spite of the all-to frequent cyclical downturns suffered by auto.

Even as the current slump deepened and output (corrected for mix and quality changes) fell an additional 2 percent, the motor vehicle and parts industry was able to show an 8.9 percent increase in productivity from 1980 to 1982. That remarkable performance attests to the competence of the workforce as well as to the robust spending on R & D and capital equipment by the domestic auto companies.

The Japanese Productivity Center, an independent Tokyo-based think-tank with researchers representing labor, business, and academia, has published a study on comparative labor productivity between the U.S. and Japan. The study estimates that Japan's auto industry has finally pulled ahead of the U.S., holding a slight — 1% — lead in productivity in 1980. In 1979, the study says, the U.S. was ahead of Japan by 11%.

These figures call into serious question some U.S. studies which show Japan holding a tremendous productivity edge vis-a-vis the U.S. Moreover, productivity changes depend strongly on utilization of capacity. The Japanese catchup from 1979 to 1980 must therefore be put in proper perspective: extremely favorable conditions in Japan, where there was a 15 percent increase in production, coupled with the massive auto crisis in the U.S., where unit output plunged 30 percent.

Although auto production levels continued to be depressed in 1981 and 1982, productivity as measured by BLS' index of output per compensated employee-hour advanced by 3.0 percent and 5.7 percent in those two years, respectively. If the industry can hike annual productivity an average of 4.3 percent under such conditions, we certainly can expect big gains as production volume rises in the recovery.

And we do. While 1983 productivity data aren't out yet, a comparison of 1983 unit output figures with data on work hours suggests a conservative estimate of 10% productivity growth over 1982. That would put the three-year gain over 1980 at an impressive 19.8 percent.

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APPENDIX N

GATT Questions Should Be Resolved within the GATT Framework

Some have argued that domestic auto content legislation should not take effect until U.S. courts rule whether it may conflict with the General Agreement on Tariffs and Trade (GATT). However, there are several good reasons why the question of the status of the legislation under the GATT should not be referred to U.S. courts.

(1) The GATT provides a mechanism for dispute resolution if one country believes that another country's measure conflicts with the terms of the GATT. First, the GATT requires a period of consultation between the disputing countries. If that fails, then the challenging country may request that a formal panel be appointed to decide the issue.

(2) In contrast to our courts, such panels are composed of experts on the GATT who are mutually satisfactory to the opposing sides.

(3) Administration officials have warned that a possible GATT challenge in U.S. courts could delay implementation of the legislation. However, if exclusive jurisdiction to resolve GATT issues is lodged in the GATT itself, then the U.S. could proceed with implementation of the law to prevent further injury from imports and avoid the harassment of lawsuits in the U.S. courts.

(4) Finally, and perhaps most importantly, the GATT provides a forum in which — if the U.S. law is challenged — the U.S. can counter-challenge against the more restrictive auto trade policies pursued by all other major auto-producing countries. These policies include higher percentages of required content (Australia), very restrictive quotas (Italy) and gentlemen's agreements (U.K. and Germany), and severe customs and inspection procedures (France and Japan). Although the U.S. courts cannot adjudicate with respect to foreign auto policies, the GATT could simultaneously resolve the legal and practical status of all those policies in the same forum.

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16. CBO, "The Fair Practices in Automotive Products Act (H.R. 5133): An Economic Assessment" and revised summary analysis submitted to the House Ways and Means Subcommittee on Trade, September 23, 1982.

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Statement submitted by David J. Steinberg, President, U.S. Council for an Open World Economy, to the Subcommittee on International Trade of the Senate Committee on Finance in a hearing on the state of the U.S. automobile industry. June 27, 1984

(The U.S. Council for an Open World Economy is a private, non-profit organization engaged in research and public education on the merits and problems of developing an open international economic system in the overall national interest. The Council does not act on behalf of any "special interest".)

This hearing is a useful way to help educate the Congress and the nation at large on the competitiveness of the U.S. auto industry, the effects of Japan's export controls on automobiles, and future prospects for international trade in automobiles. However, it calls to mind a sort of lopsidedness in our government's attention to the problems and prospects of the U.S. automotive industry. Congressional hearings should be focused on a coherent U.S. policy concerning this industry. But there is no such policy. The Administration, since taking office in January 1981, has had an automobile import-control policy (affecting imports from Japan), but there is no framework for such controls (if these are justifiable at all) in a coherent adjustment/redevelopment strategy for the automotive industry -- a strategy, systematically reviewed by Congress, addressing the real problems and needs of this major industry in a rapidly changing world. Inter alia, there is no reassessment of all statutes and regulations materially affecting the industry's adjustment capability in order to determine if there are any inexcusable inequities that need correction. There is no strategy to which management and labor are required to make suitable commitments as a condition for any government assistance that may be justifiable.

In short, we have an auto import-control policy but no coherent auto policy -- a lopsidedness that, among other shortcomings, makes the import controls a sort of "pig in a poke". There is no sign that correction of this policy deformity is at hand. Coherent attention to the real problems of the auto industry is necessary regardless of the fate of the current import controls.

When the Reagan administration took office, I said it should "hit the ground running" on the fierce problems of the U.S. auto industry even though the International Trade Commission had just found that imports had not caused and did not threaten serious injury. The Administration did indeed hit the ground running -- running to Tokyo to pressure the Japanese government to restrict exports of automobiles to the United States. Obviously, this was not what I had in mind. There is no indication that either the Administration or the Congress has grasped the importance of the policy reform I have been proposing if there is to be any assistance at public expense (in other words, subsidy) to this or any other industry.

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